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OCIE Risk Alert Highlights Adviser Best Execution Deficiencies

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Investment advisers, as fiduciaries, have an obligation to seek "best execution" of client transactions when selecting broker-dealers and executing client trades.[1] This duty to seek "best execution" does not simply mean seeking the lowest commission cost. Instead, it means considering the full range and quality of a broker-dealer's services and determining "whether the transaction represents the best qualitative execution" for the client.[2] Complying with this obligation can be challenging for advisers that fail to adopt and follow well-designed policies and procedures. Earlier this summer, the Office of Compliance Inspections and Examinations (the "OCIE") released a Risk Alert highlighting the most frequent compliance issues with respect to the best execution obligation.[3] The Risk Alert identified the following issues as the most-observed deficiencies among over 1,500 adviser examinations:

- Not Performing Best Execution Reviews. The advisers either did not conduct an evaluation of best execution when selecting a broker-dealer or could not demonstrate through documentation that they performed such evaluation.[4]
- Not Considering Materially Relevant Factors During Best Execution Reviews. The advisers did not consider the full range and quality of a broker-dealer's services when directing brokerage. In some instances, the Advisers did not evaluate such factors. In others, they failed to solicit and review input from traders and portfolio managers.[5]
- Not Seeking Comparisons From Other Broker-Dealers. The advisers used a single broker-dealer without comparison to other broker-dealers initially or on an ongoing basis.[6]
- Not Fully Disclosing Best Execution Practices. The advisers did not provide full disclosure of their best execution practices. In some instances, advisers did not review trades to ensure that prices obtained fell within a reasonable range, contrary to statements made in the advisers' brochures. [7]
- Not Disclosing Soft Dollar Arrangements. The advisers did not provide full and fair disclosures of their soft dollar arrangements in their Form ADVs.[8]
- Not Properly Administering Mixed Use Allocations. The advisers did not make a reasonable allocation of the cost of mixed use product or service or did not produce a rationale supporting mixed use allocations.[9]
- Inadequate Policies and Procedures Relating to Best Execution. The advisers had inadequate compliance policies and procedures with respect to best execution.[10] In some instances, the policies and procedures were poorly tailored to the adviser's business. In others, the policies and procedures failed to address best execution all together.[11]

- Not Following Best Execution Policies and Procedures. The advisers were not following their own policies regarding best execution review, allocation of soft dollar expenses, or ongoing monitoring of execution price and research by broker-dealers.[12]

The Risk Alert is a clear signal that the OCIE has noticed the prevalence of the above deficiencies and will look for them in future adviser examinations. Advisers should act now by reviewing their policies and procedures with respect to their best execution obligation and their compliance with those policies and procedures. If you have any questions related to the best execution obligation or investment adviser regulation generally, please feel free to contact us. ***John I. Sanders*** and ***Lauren Henderson*** are associated based in the firm's Winston-Salem office. [1] *SEC Office of Compliance Inspections and Examinations, Compliance Issues Related to Best Execution by Investment Advisers (July 11, 2018), available at https://www.sec.gov/ocie/announcement/risk-alert-most-frequent-best-execution-issues-cited-adviser-exams-1* [2] *Id.* [3] *Id.* [4] *Id.* [5] *Id.* [6] *Id.* [7] *Id.* [8] *Id.* [9] *Id.* [10] *Id.* [11] *Id.* [12] *Id.*