

Special Alert

November 18, 2020

OCIE RISK ALERT: Supervision, Compliance, and Multiple Branch Offices

On Nov. 9, 2020 the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a risk alert detailing its series of examinations of investment advisers operating from numerous branch offices and with operations geographically disbursed from the adviser's main office. This examination initiative focused on the compliance and supervisory practices relating to advisory personnel working within the advisers' branch offices. The initiative focused on advisers' compliance programs, supervision and investment advice.

Compliance and Supervision

OCIE staff reviewed firms' main and branch office practices for compliance with certain rules, such as the Code of Ethics rule and Custody Rule and consistency with fiduciary obligations, such as those related to fees, expenses and advertising. OCIE's initiative revealed that a vast majority of firms were deficient in at least one area related to the Compliance Rule (Advisers Act Rule 206(4)-7), with the most frequent citations falling into one of the categories below.

Custody of Client Assets

Advisers did not have policies and procedures that limited the ability of supervised persons to process withdrawals and deposits and/or change client addresses of record. Advisers, often unintentionally, had custody of client assets in instances where advisers commingled their assets with their clients, served as trustees to client accounts, were general partners to an advised limited partnership, received client checks in satellite offices and deposited them with client custodians, or had overly broad disbursement authority.

Fees and Expenses

The majority of fee-billing issues stemmed from a lack of oversight over fee-billing processes, leading to clients being overcharged. Overcharging occurred in numerous ways, such as misapplying tiered fee schedules, inconsistently applied fee reimbursements, and fees being charged which were different than those in the advisory agreement, or on assets excluded from advisory fees.

Oversight and Supervision of Supervised Persons

OCIE highlighted supervision deficiencies related to failure to disclose material information, including the identification and documentation of disciplinary events of supervised persons, portfolio management (such as recommending mutual fund share classes that were not in a client's best interest), and trading and best execution. OCIE noted supervision deficiencies were most prevalent in situations involving advisers overseeing branch office personnel with higher-risk profiles.

[NEXT](#)

Advertising

Advisers often had deficiencies related to advertising prepared by supervised persons located in branch offices and/or operating under a DBA. Examples of problematic advertisements included performance presentations that omitted material disclosures, superlatives or unsupported claims, professional experience or credentials of supervised persons of the firm that were falsely stated, and third-party rankings or awards that omitted material facts regarding the ranking or award.

Code of Ethics

Identified code-of-ethics deficiencies included failure to: comply with reporting requirements, review transactions and holdings reports, identify access persons correctly, and include all required provisions in the Code of Ethics.

Investment Advice

OCIE staff evaluated advisers' oversight of investment recommendations, both within specific branch offices and across all of an adviser's branch offices, management and disclosure of conflicts of interest. In addition, OCIE reviewed advisers' allocation of investment opportunities.

Oversight of Investment Recommendations

Deficiencies in this area were most often related to the purchase of mutual fund share classes that charged 12b-1 fees instead of lower cost share classes of the same mutual funds that were available to clients. Advisers stood to benefit from clients paying for higher cost share classes, which created a conflict of interest that was not disclosed to clients. Additionally, OCIE found issues with advisers failing to adequately determine whether wrap fee programs were in the best interest of clients and failed to have appropriate disclosures regarding issues such as trading away practices and delegation responsibility. Furthermore, OCIE noted advisers who implemented automated rebalancing of accounts that cause clients to incur short-term redemption fees from mutual funds.

Conflicts of Interest Disclosures

Various advisers were cited for failing to properly disclose conflicts of interest, such as expense allocations that benefited proprietary fund clients over non-proprietary fund clients, and financial incentives tied to specific investment recommendations.

Trading and Allocation of Investment Opportunities

OCIE cited various advisers for issues such as lack of documentation demonstrating best execution analysis, completing principal transactions without prior client consent and inadequate monitoring of supervised person's trading.

Helpful Practices

Amid all of the issues surrounding compliance and multiple branches, OCIE observed numerous practices which, if adopted, could assist advisers in creating and carrying out policies and procedures in accordance with the Compliance Rule. In general, effective advisers had written compliance policies and procedures that were applicable to all office locations and all supervised persons, include unique aspects associated with individual branch offices and specifically addressing compliance practices necessary for branch office oversight.

Some of the specific practices adopted by advisers include:

- Uniform policies and procedures with main office oversight on the monitoring and approving of advertising;
- Centralized, uniform processes to manage client fee billing;
- Centralized processes for monitoring and approving personal trading activities for all supervised persons, regardless of location;
- Uniform portfolio management policies and procedures, portfolio management systems, or both, across all office locations;
- Performing compliance testing of key activities at all branch locations, at least annually, such as:
 - Validating that branch offices reviewed portfolio management decisions;
 - Designating individuals within branch offices to provide portfolio management monitoring;
 - Consolidating trading activities within branch offices into the advisers' overall testing scheme; and
 - Conducting reviews that did not rely on self-reporting;
- Policies and procedures to screen for prior disciplinary events during the hiring process and periodically confirming their accuracy – including, as applicable, heightened supervision of individuals with disciplinary histories; and
- Requiring compliance training for all branch office employees semi-annually or at least annually.

<https://www.sec.gov/files/Risk%20Alert%20-%20Multi-Branch%20Risk%20Alert.pdf>

[BACK](#)

[RETURN TO TOP](#)

Questions? Contact the DCS Team

Dinsmore Compliance Services (DCS), an affiliate of Dinsmore & Shohl LLP, offers compliance solutions for investment managers and municipal advisers. DCS will help you develop and maintain high-quality compliance programs customized to your particular business demands and operational realities. We offer these services, all as an affiliate of a coast-to-coast, full-service law firm.

Kevin Woodard

President
(513) 977-8646
kevin.woodard@dinsmorecomplianceservices.com

Jeff Chapman

Director of Client Relations
(513) 977-8647
jeff.chapman@dinsmorecomplianceservices.com

dinsmorecomplianceservices.com