

BRANCH EXAM CHECKLIST

Scheduling of Branch Exams is covered in our CRP resource, *This Month in Compliance – June 2021*. Over the last year, firms may have held Branch Exams remotely or even skipped in 2020. We believe the SEC will be focused on examinations of firms with branch offices and will be “testing” for how supervision was conducted over this year of “remote offices.”

On November 9, 2020, the SEC issued a Risk Alert summarizing the observations from a series of examinations that focused on SEC-registered investment advisers operating from numerous branch offices and with operations geographically dispersed from the adviser's principal or main office (“Multi-Branch Initiative” or “Initiative”). This Initiative focused on, among other things, the assessment of the compliance and supervisory practices relating to advisory personnel working within the advisers' branch offices. The Multi-Branch Initiative focused on certain practices of advisers in the following areas:

- **COMPLIANCE PROGRAMS AND SUPERVISION** - The staff focused on advisers' compliance programs in both their main offices and branch offices; and the oversight by the main offices of advisory services provided through branch offices. In particular, the staff reviewed firms' main and branch office practices for: (1) compliance with certain rules, such as the “Code of Ethics Rule” and “Custody Rule”; 5 and (2) consistency with fiduciary obligations, such as those related to fees, expenses, and advertising.
- **INVESTMENT ADVICE** - The staff evaluated the processes by which firms' supervised persons located in branch offices provided investment advice to advisory clients, including the formulation of investment recommendations and the management of client portfolios. In conducting these examinations, the staff focused on the advisers': (1) oversight of investment recommendations, both within specific branch offices and across all of the advisers' branch offices; (2) management and disclosure of conflicts of interest; and (3) allocation of investment opportunities.
- **RECENT SEC EXAM** - CRP consultants took notice that in a recent SEC exam document request, the SEC asked for: (1) “A list of all offices (including the address), other than an adviser's principal place of business, where ten advisory books and records are kept; (2) a list of advisory services that are performed; (3) how adviser's Supervised Persons interface or transact with Clients or investor (collectively, “remote office”) (4) if the adviser or any of its Supervised Persons conduct business under a different name in any of these remote offices, also provide the name under which services are provided (“DBA name”).” This exam is just beginning, so we will report on any other significant inquiries from the SEC.

COMPLIANCE AND SUPERVISION

The vast majority of the examined advisers were cited for at least one deficiency related to the Compliance Rule. In particular, the staff observed that more than one-half of these advisers had compliance policies and procedures that were: (1) ***inaccurate because they included outdated information, such as references to entities no longer in existence and personnel that had changed roles and responsibilities***; (2) ***not applied consistently in all branch offices***; (3) ***inadequately implemented because, among other things, the compliance department did not receive records called for in the policies and procedures***; or (4) ***not enforced***.

The Compliance Rule issues often were related to the advisers failing to recognize that they had custody of clients' assets, failing to adequately implement and oversee their fee billing practices, or both. Examples of compliance program-related shortcomings in these two areas discussed below:

- **CUSTODY OF CLIENT ASSETS.** Advisers did not have policies and procedures that limited the ability of supervised persons to process withdrawals and deposits in client accounts, change client addresses of record, or do both. Advisers had custody of their client's assets due to a variety of practices, including instances where the adviser: (1) comingled its assets with those of its clients; (2) was the trustee for client accounts (or its supervised persons were trustees); (3) was the general partner to an advised limited partnership; and/or (4) had various arrangements in place that gave it broad disbursement authority over client assets. By taking these actions, the

examined advisers, perhaps unknowingly, had custody of client assets and were therefore required to follow the provisions of the Custody Rule.

- **FEES AND EXPENSES.** Advisers did not have policies and procedures that included identifying and remediating instances where undisclosed fees were charged to clients. In addition, policies and procedures governing such fees, including those related to wrap fee programs, were not enforced. Most fee billing issues were related to the lack of oversight over fee billing processes, and in some cases, this resulted in overcharges to clients. Clients were overcharged advisory fees in a variety of ways, such as when the adviser: (1) used inaccurate fee calculations by, for example, misapplying tiered fee structures or employing incorrect valuations for the calculations; (2) inconsistently applied fee reimbursements, including for advisory fee offsets for 12b-1 fees from certain mutual fund purchases and refunds for prorated fees paid in advance by clients who terminated their accounts; and (3) charged fees different than the rates included in advisory agreements or on assets that were to be excluded from advisory fees.
- **OVERSIGHT AND SUPERVISION OF SUPERVISED PERSONS.** Supervision deficiencies related to: (1) the failure to disclose material information, including disciplinary events of supervised persons; (2) portfolio management, such as the recommendation of mutual fund share classes that were not in the client's best interest; and (3) trading and best execution, including enforcing policies and procedures the adviser had in place. Supervision deficiencies were particularly prevalent when the advisers oversaw branch office personnel with higher-risk profiles, and this included instances related to the identification and documentation of disciplinary events.
- **ADVERTISING.** Advisers often had deficiencies related to advertising, both generally and specifically regarding the materials prepared by supervised persons located in branch offices and/or supervised persons operating under a name different than the primary name of the adviser (also known as "doing business as" or "DBAs"). Examples of problematic advertisements included: (1) performance presentations that omitted material disclosures; (2) superlatives or unsupported claims; (3) professional experience and/or credentials of supervised persons or the advisory firm that were falsely stated; and (4) third-party rankings or awards that omitted material facts regarding these accolades.
- **CODE OF ETHICS.** Several of the advisers were cited for code of ethics deficiencies because they failed to: (1) comply with reporting requirements, including by submitting transactions and holdings reports less frequently than required by the rule or not submitting such reports at all; (2) review transactions and holdings reports; (3) properly identify access persons; or (4) include all required provisions in their codes of ethics. Examples of provisions omitted from codes of ethics include those requiring: a review and approval process prior to supervised persons investing in limited or private offerings; initial and annual holdings report submissions; and/or quarterly transaction report submissions.

COMPLIANCE POLICIES, PROCEDURES AND PRACTICES

During the course of these examinations, the staff observed a range of practices with respect to branch office activities that firms may find helpful in their compliance oversight efforts.

- Advisers ***adopted and implemented written compliance policies and procedures that:***
 - were applicable to all office locations and all supervised persons – regardless of whether these individuals were independent contractors or employees of the adviser;
 - include unique aspects associated with individual branch offices; and
 - specifically address compliance practices necessary for effective branch office oversight.
- ***Uniform policies and procedures regarding main office oversight*** for monitoring and approving advertising, particularly in instances where branch offices were permitted to ***advertise through DBA websites.***
- ***Centralized, uniform processes to manage client fee billing.*** Advisers with centralized, uniform processes tended to limit exceptions from these approved processes. In addition, these centralized processes mitigated instances in which supervised persons or branch offices had independent billing options or fee arrangements that deviated from client agreements or disclosures.

- **Centralized processes for monitoring and approving personal trading activities for all supervised persons** located in all office locations. For some advisers, the centralized process included an automated review and approval of personal trading requests and transactions. Many of these advisers also provided supervised persons with training related to their codes of ethics and personal trading policies.
- **Uniform portfolio management policies and procedures, portfolio management systems, or both, across all office locations.** For some advisers, trade orders were also centralized through the main office.
- **Advisers performed compliance testing or periodic reviews of key activities at all branch offices at least annually,** with some firms conducting reviews more frequently. Examples of compliance oversight and testing of branch office activities included:
 - Validating that branch offices undertook compliance or supervision reviews of their portfolio management decisions, both initially and on an ongoing basis.
 - Designating individuals within branch offices to provide portfolio management monitoring, primarily to assess whether investment recommendations were consistent with clients' investment objectives or recommendations.
 - Consolidating the trading activities occurring within branch offices into the advisers' overall testing practices.
 - Conducting compliance reviews that did not solely rely on self-reporting by personnel.
- **Advisers established compliance policies and procedures to check for prior disciplinary events when hiring supervised persons and periodically confirming the accuracy of disclosure** regarding such information. In addition to initially reviewing for disciplinary histories when hiring personnel, some advisers also had procedures that included periodically reviewing disciplinary histories, documenting such reviews, and providing heightened supervision of individuals with disciplinary histories.
- Advisers **required compliance training for branch office employees.** Most advisers required compliance-related training for branch office employees, targeting areas identified as needing improvement based on their branch office reviews. Typically, such training was required semi-annually or at least annually.

THIS MONTH'S RESOURCE – SAMPLE BRANCH EXAM CHECKLIST

[Click here to access and review the full Risk Alert.](#)