

Time to Check Your Best Execution Practices



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In a recent [Risk Alert](#) from the SEC’s Office of Compliance Inspections and Examinations (“OCIE”), “best execution” deficiencies were cited from recent examinations of investment advisers. These deficiencies reflect issues identified in examinations of over 1,500 adviser examinations.

Best execution obligations under the Investment Advisers Act of 1940 impose a fiduciary standard for investment advisers. This duty is also part of longstanding Commission guidance, which states that as a fiduciary, an investment adviser owes a duty to its clients to achieve the best execution when placing trades. Importantly, best execution is a duty to execute transactions for a client so that the client’s costs or proceeds in each transaction are the most favorable under the circumstances. A review of best execution practices should factor in both quantitative and qualitative criteria. Some criteria to consider as part of this review include:

- Execution and operational capabilities of the broker-dealer.
- Expertise of the broker-dealer.
- Access to people, products, and services through the broker-dealer.
- Financial condition and business reputation of the broker-dealer.
- Trade implementation costs.

Compliance Issues Relating to Best Execution

Below are examples of many of the most common deficiencies associated with advisers’ best execution obligations identified by OCIE staff.

Area	Deficiency	Remediation
Best Execution Reviews	<ul style="list-style-type: none">• Advisers did not evaluate best execution when selecting a broker-dealer to execute transactions or were unable to demonstrate, through	<ul style="list-style-type: none">• Advisers should demonstrate that they periodically and systematically evaluate the execution performance of broker-dealers used to execute client transactions

	documentation or otherwise, that they performed such an evaluation.	
Relevant factors to consider during best execution reviews	<ul style="list-style-type: none"> Advisers did not evaluate any qualitative factors relating to a broker-dealer including, among other things, the broker-dealer's execution capability, financial responsibility, and responsiveness to the adviser. 	<ul style="list-style-type: none"> Advisers should consider the full range and quality of a broker-dealer's services in directing brokerage. Advisers should solicit and review input from the adviser's traders and portfolio managers.
Not seeking comparisons from other broker-dealers	<ul style="list-style-type: none"> Advisers that utilized a single broker-dealer for all clients without seeking comparisons from competing broker-dealers initially and on an ongoing basis to assess their chosen broker-dealer's execution performance. 	<ul style="list-style-type: none"> Advisers should use broker-dealers by seeking out or considering the quality and costs of services available from other broker-dealers. Advisers using a single broker-dealer should do so based on more than solely on cursory reviews of the broker-dealer's policies and prices. Advisers using a broker-dealer based solely on that broker-dealer's summary of its services should seek comparisons from other broker-dealers.
Full Disclosing of Best Execution Practices	<ul style="list-style-type: none"> Advisers did not disclose that certain types of client accounts may trade the same securities after other client accounts and the potential impact of this practice on execution prices. Advisers, contrary to statements in their brochures, did not review trades to ensure that prices obtained fell within an acceptable range. 	<ul style="list-style-type: none"> Advisers should provide full disclosure of best execution practices
Disclosure of Soft Dollar Arrangements	<ul style="list-style-type: none"> Advisers did not adequately disclose the use of soft dollar arrangements. Advisers did not disclose that certain clients may bear more of the cost of soft dollar arrangements than other clients. Advisers did not appear to provide adequate or accurate disclosure regarding products and services acquired with soft dollars that did not qualify as eligible brokerage and research services under the Section 28(e) safe harbor. 	<ul style="list-style-type: none"> Advisers should provide full and fair disclosure in Form ADV of their soft dollar arrangements. Full and fair disclosure of these research and brokerage service arrangements is a requirement on Form ADV.
Administration of Mixed Use Allocations	<ul style="list-style-type: none"> Advisers did not appear to make a reasonable allocation of the cost of a mixed-use product or service according to its use or did not produce support, through documentation or otherwise, of the rationale for mixed use allocations. 	<ul style="list-style-type: none">
Best Execution Policies and Procedures	<ul style="list-style-type: none"> Advisers did not have any policies relating to best execution. Advisers with insufficient internal controls because the advisers failed to monitor broker-dealer execution performance. Advisers with policies that did not consider the current business of the adviser, including the type of securities traded by the adviser. Advisers did not follow their policies regarding best execution review, including seeking comparisons from competing broker-dealers to test for pricing and execution. Advisers did not allocate soft dollar expenses per their policies. Advisers did not follow their internal policies regarding the ongoing monitoring of execution price, research, and responsiveness of their broker-dealers. 	<ul style="list-style-type: none"> Advisers should have adequate compliance policies and procedures to assess best execution compliance. Advisers should have and internal controls regarding best execution that include the "ongoing monitoring of execution price, research, and responsiveness of their broker-dealers." Advisers should follow their policies and procedures regarding best execution.

Best Execution Reviews – Recommendations

An investment adviser can fulfill its best execution obligations adopting policies and procedures that state the factors the investment adviser will use when choosing brokers. But having policies along is not sufficient, an adviser must also follow the policies.

What should investment advisers do?

- Institute a best execution committee or working group to oversee best execution practices.
 - Include representatives from the compliance staff, the trading staff, and the portfolio management, staff.
- Conduct reviews to evaluate whether the adviser is obtaining best execution for its clients.
 - Determine whether the totality of the services received by the investment adviser and its clients were adequate considering the commissions paid.
 - Examine existing best execution policies to ensure that they adequately protect the interests of their clients and are appropriate for their businesses.
 - Engage traders by requesting that they submit evaluations of the brokers.
 - Compare the results of the evaluations to the amount of trading activity carried out with each broker.
 - If there is a disparity between the broker evaluations and the order flow, further inquiry would be warranted.
 - Act transparently and make accurate representations.
 - Fully evaluate any potential conflicts of interest that may exist in connection with their execution decisions.

- Create policies to identify and mitigate conflicts.
 - Include an examination of any potential conflicts.
- Confirm the accuracy of the disclosures to make sure client contracts all accurately describe the trading activities of the investment adviser:
 - These documents include:
 - investment adviser's Form ADV;
 - fund offering documents; and
 - client contracts all accurately describe the trading activities of the investment adviser.
 - Factor in any changes in these documents as warranted.

Conclusion

In issuing the Risk Alert, OCIE encouraged advisers to use the guidance to help review their best execution practices, policies, and procedures in these areas. Such reviews can help advisers determine what types of changes may be needed: amendments to disclosures regarding best execution or soft dollar arrangements, updated policies, and procedures, or expanded oversight/monitoring of practices regarding best execution or soft dollar arrangements. In the end, investment advisers should use this opportunity to conduct some level of review and as needed improve their best execution programs.

Read More:

OCIE Risk Alert

<https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20IA%20Best%20Execution.pdf>