RIAs Need to Ensure that Branch Offices Are in Compliance

By Les Abromovitz

Oversight of Registered Investment Advisers (“RIAs”) and broker-dealers is a huge undertaking.

When the SEC’s Office of Compliance Inspections and Examinations (“OCIE”) announced its 2017 priorities, the publication noted that OCIE oversees more than 4,000 broker-dealers, including roughly 162,000 branch offices and 640,000 registered representatives. OCIE also oversees more than 12,000 investment advisers with a growing number of branch offices.

In recent years, OCIE has found that more RIAs are utilizing a business model with numerous branch offices and operations that are geographically dispersed from the firm’s principal or main office. To address the unique risks arising from the branch office business model, OCIE launched its Multi-Branch Adviser Initiative to ensure that RIAs are closely supervising their branch offices. The purpose of the initiative is to protect investors by ensuring that these branch offices comply with federal securities laws.

It’s no surprise that OCIE is scrutinizing branch offices

OCIE’s Multi-Branch Adviser Initiative should come as no surprise to RIAs. When OCIE published its 2017 compliance priorities, branch offices were mentioned specifically:

Multi-Branch Advisers. We will continue to focus on registered investment advisers that provide advisory services from multiple locations. The use of a branch office model can pose unique risks and challenges to advisers, particularly in the design and implementation of a compliance program and the oversight of advisory services provided at branch offices.

In its 2016 examination priorities document, OCIE said this:

Branch Offices. We will continue to review regulated entities’ supervision of registered representatives and investment adviser representatives in branch offices of SEC-registered investment advisers and broker-dealers, including using data analytics to identify registered representatives in branches that appear to be engaged in potentially inappropriate trading.

OCIE sent a similar message in 2015 when it announced its compliance priorities:

Branch Offices. We will focus on registered entities’ supervision of registered representatives and financial adviser representatives in branch offices, including using data analytics to identify branches that may be deviating from compliance practices of the firm’s home office.

With the launching of its Multi-Branch Adviser Initiative, OCIE once again communicated the importance of implementing compliance programs designed to oversee advisory services delivered at branch offices.

Addressing the risks arising from firms’ use of branch offices

Even with robust policies and procedures, oversight of advisory services provided at remote locations is challenging. When using the term “branch” office, OCIE is generally referring to a place of business other than the RIA’s principal office.

Pursuant to its Multi-Branch Adviser Initiative, OCIE will review advisory books and records and will interview members of the firm. The goal is to evaluate:
• The implementation and effectiveness of policies and procedures at the primary and branch offices;
• How supervision is customized to the unique risks that arise at branch offices;
• The role and empowerment of compliance staff members who are responsible for the oversight of branch offices, including their level of access to relevant information and documents; and
• Whether the RIA’s branch office filings, such as Form ADV, is accurate when compared to the firm’s actual practices.

OCIE examiners will also focus on the firm’s specific business activities to assess compliance and testing controls in risk areas such as:

• **Fees and Expenses.** Calculation of fees and other expenses, as well as the effectiveness of billing and invoicing controls and client communications;
• **Advertising.** Controls over advertising, which includes the process for reviewing and approving advertisements concentrating on those that are created or circulated by the branch office;
• **Code of Ethics.** Oversight and monitoring of personal securities transactions, as well as the identification of branch office access persons; and
• **Custody.** Identification of accounts over which the RIA maintains custody, as well as branch office staff’s involvement in making these determinations.

The Custody Rule is found in Rule 206(4)-2 under the Investment Advisers Act.

**Oversight of IARs’ investment recommendations**

Examiners will review the process by which investment advice, including recommendations and management of client portfolios, is provided to advisory clients by supervised persons in the branch office. Examiners will focus on policies and procedures, as well as supervisory controls governing this advice. Special attention will be paid to how potential conflicts of interest are identified and the level of autonomy given to supervised persons providing advice.

Depending upon the RIA’s specific business activities, examiners may assess compliance and testing controls in these risk areas:

**Oversight.** Supervision and review of investment recommendations made within a particular branch office and across branch offices, including investment authority, suitability of recommendations, and statements made by Investment Adviser Representatives (“IARs”) to clients regarding the due diligence undertaken with respect to investments.

**Conflicts of Interest.** Identification, management, and disclosures of conflicts of interest that arise at the branch office, such as compensation arrangements and outside business activities.

**Allocation of Investment Opportunities.** How investment opportunities are allocated among client accounts, including how trading activity is monitored and what disclosures are made to clients pertaining to trade allocation.

During every examination, examiners are evaluating whether RIAs and IARs have fulfilled their fiduciary obligations to clients.

**Conclusion**

When it launches an initiative, OCIE is encouraging RIAs to review their policies and procedures in a specific area, even if there is little chance that the firms will be examined. Ideally, every RIA with a branch office will bolster its policies and procedures.

Aside from strengthening branch offices policies and procedures, Chief Compliance Officers (“CCOs”) should document that they are addressing the risks that are likely to arise. For example, if IARs in a branch office have a history of disciplinary problems, heightened supervision is required.

In a recent deficiency letter, examiners criticized an RIA because its CCO’s reviews of branch offices fell short of the examination team’s expectations. Examiners told the CCO that he should have reviewed more files during his branch office visits. Examiners found that a small sample size of less than two percent significantly reduces the likelihood that errors will be found. Examiners concluded that this inadequate review represented a weakness in the firm’s internal controls, which might result in a securities law violation. Examiners reached this conclusion, even though there was no harm to clients receiving advice at branch offices.

The CCO was also criticized, because he did not review files for unapproved branch office or IAR marketing. In addition, he did not conduct due diligence to uncover any unapproved use of social media. The RIA was told to adopt policies and procedures requiring the firm to conduct Internet and social media searches to determine if branch office personnel and other IARs were utilizing inappropriate marketing materials. ★