

MEMORANDUM

August 8, 1995

TO: Regional Directors
District Administrators
(Regulation) Associate Directors, Assistant Directors
Branch Chiefs, Team Leaders and Examiners

FROM: Lori Richards *LR*
Gene Gohlke
Mary Ann Gadziala
Mark Fitterman
Gladwyn Goins

As you know, the industry we examine has drastically changed in the last decade or so. It has grown (in terms of assets under management and public customers) and become more complex, as new products are developed and brought to market and as regulated entities strive to provide new services to the public. It is critical that the Commission's exam program continue to be responsive to these changes in the industry, and that we use our limited resources in the most effective manner possible. To that end, we must work together to move the exam program in some new directions. Many of the changes described below arose from your recommendations. Some of the changes are well underway, and others, which are under consideration, are more long-term. We need your assistance in this effort and wanted to bring all of you up to date on many of the key issues we are focusing on:

- Because of the size of the industry, (compared to that of our exam staff), we should increase our emphasis on careful selection of registrants to examine based on an assessment of "risk factors." We are designing these risk factors to indicate a higher probability of finding problems (and enforcement referrals). Regional exam staff should be given more discretion to select the registrants they examine, using the "risk factors."
- We should conduct customized "smart examinations." With respect to large mutual funds and brokerage firms, rather than doing comprehensive top-to-bottom "checklist" type examinations, examiners should be narrowing the scope of their exams to those several or more areas which are critical to the registrant's business (or where internal controls appear to be weak), and closely scrutinizing those areas in more focused, targeted exams.
- Increasingly, we'll need to pay close attention to the overall internal control environment at all regulated firms, and identify areas where there may be material weaknesses

through discussions with management and review of records. We will be expanding our exam modules to include more precise reviews in this area.

- In broker-dealer exams, we will be conducting more "surveillance" exams and fewer oversight exams.
- We'll be giving increased attention to sales practices.
- We'll be coordinating exams of dually registered entities, and creating exam teams composed of examiners with different expertise.
- We will be tracking the type of enforcement referrals we make so that we can target those areas in future exams.
- Reflecting the changes in the industry, we will be working closely with other regulators by: 1) working with bank regulators to share examination techniques and ideas through training and other activities; 2) conducting a pilot program of joint exams with the OCC; and 3) conducting joint IA exams with state securities regulators.
- We're undertaking a "De-Registration Program" to eliminate adviser registrants who do not need to be registered or examined.
- We are reemphasizing the need for excellent continuing education programs for examiners.

As we prepare for fiscal 1996, these concepts will be increasingly incorporated into the exam program. As always, we welcome your ideas and input on these changes and other ways to enhance the program.

cc: Becker
Barbash
McLucas