

Annual SIFMA-CL Conference: “Top 10½” Examination Priorities for 2008

April 1, 2008

The April 1 General Session of the annual SIFMA-CL Conference, “Current SEC Issues,” featured SEC senior staff members Andrew “Buddy” Donohue, Lori Richards, Erik Sirri, Andrew Vollmer, and Shelley Parratt. David DeMuro of Lehman Brothers moderated.

During the panel discussion, Lori Richards, Director of the SEC’s Office of Compliance, Inspections, and Examinations, outlined her “Top 10½” Examination Priorities for 2008:

- 1. Valuation:** Ms. Richards emphasized the importance of strong internal controls in the valuation of securities. Although Ms. Richards did not specifically mention complex products in discussing valuation, much of her presentation was focused on complex asset-backed products.
- 2. Controls over nonpublic information:** The Staff will focus on compliance with Section 15(f) of the Exchange Act and Section 204A of the Advisers Act, while considering the following questions: (a) Has the firm identified its various sources and types of material nonpublic information? (b) Has the firm designed appropriate controls? (c) Have the controls been implemented? (d) How confident is the firm that its controls are effective? (e) What testing has the firm performed? In addition to traditional forms of material nonpublic information (e.g., deal information), the Staff will inquire about customer orders, firm research, and customer credit.
- 3. Retail sales practices:** The Staff will continue its focus on Chairman Cox’s priority of protecting senior investors. Ms. Richards referred the conference attendees to the report published by the Commission last fall concerning free lunch programs. The Staff is working on a project to collect and publish best practices in the area of sales to seniors and is encouraging firms to provide examples of such policies and procedures to the Staff. In addition to seniors, the Staff will examine suitability issues, particularly with respect to CMOs and other complex products.
- 4. Supervision:** The Staff has found that some firms have policies and procedures that they have never implemented, while other firms are engaged in areas for which they do not have any policies or procedures at all. Among other things, the Staff will be reviewing supervision at OSJs, focusing on outside business activities and producing managers in certain business models, and checking for compliance with new FINRA Rule 2821 regarding variable annuities.

5. Net capital/internal controls: In light of recent events and current market conditions, the Staff has increased its focus on firms' procedures to satisfy net capital requirements.

6. Trading: The Staff will continue its existing focus on best execution and firms' compliance with other trading rules, including Reg. NMS and Reg. SHO.

7. Fixed income: The Staff will focus on issues involving pricing, markups, and suitability of fixed income products and, in particular, CDOs and CMOs. In addition, the Staff is turning its attention to pay-to-play arrangements in the area of municipal securities.

8. Rating agency issues

9. Conflicts of interest: Ms. Richards revealed that the Staff is focused on new revenue-sharing payment streams from advisers to broker-dealers for appearing on "recommended advisers" lists. Other conflicts of interest under scrutiny include indirect payments by customers for access to IPOs and sales of securities by broker-dealer firms in which they or an affiliate have an interest.

10. Anti-money laundering: Ms. Richards stated that the SEC Staff and FINRA have begun to use a new uniform AML examination module, which should provide consistency across examination programs. The Staff will review firms' customer identification programs and testing of their AML compliance procedures.

10.5. Information and account security: The Staff will examine firms' efforts to protect customer assets and information, including controls over customer changes of address, wire transfers and account statements. The Staff will pay particular attention to firms' controls over customer information security when activities are outsourced. In addition, the Staff is focused on Business Continuity Planning by mid-sized firms.

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