GAO
Accountability·Integrity·Reliability

Highlights

Highlights of GAO-07-1053, a report to congressional requesters

Why GAO Did This Study

After widespread unlawful trading practices surfaced in the mutual fund industry in late 2003, the Securities and Exchange Commission (SEC), through its Office of Compliance Inspections and Examinations (OCIE), took steps intended to revise its examination process to better identify and focus its resources on those activities representing the highest risk to investors. More recently, some registrants raised concerns about the lack of communication from SEC examiners about the status of and results of examinations. This report (1) describes OCIE's revisions after 2003 to the examination approach for investment companies and investment advisers; (2) discusses OCIE's compliance with its examination exit procedures; and (3) describes reforms OCIE implemented since January 2006 to enhance, among other things, communication with registrants. To address these objectives, GAO analyzed OCIE examination data; planning documents and guidance; interviewed OCIE officials; and gathered views of registrants.

What GAO Recommends

GAO recommends that SEC consider relocating its registrant complaint hotline to an independent office, such as an ombudsman function, within the agency or within a division or office outside of OCIE. SEC generally agreed and is taking steps to address the intent of the recommendation.

www.gao.gov/cgi-bin/getrpt?GAO-07-1053.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Orice M. Williams (202) 512-8678 or williamso@gao.gov.

August 2007

SECURITIES AND EXCHANGE COMMISSION

Steps Being Taken to Make Examination Program More Risk-Based and Transparent

What GAO Found

Since the detection of mutual fund trading abuses in late 2003, OCIE has shifted its approach to examinations of investment companies and investment advisers from one that focused on routinely examining all registered firms, regardless of risk, to one that focuses on more frequently examining those firms and industry practices at higher-risk for compliance issues. The effectiveness of OCIE's revised approach largely depends on OCIE's accurately assessing the risk level of investment advisers. The method that OCIE employs to predict the level of risk for the majority of investment advisers has some limitations, particularly in that this method relies on proxy indicators of compliance risks without incorporating information about the relative strength of a firm's compliance controls. OCIE has taken steps to assess the effectiveness of this method for predicting risk-levels and to seek additional indicators of compliance risks. GAO continues to believe that implementing GAO's prior recommendation to obtain and use compliance reports from firms—a source of information on the effectiveness of their compliance controls—could potentially help OCIE better identify higher-risk firms.

GAO's review of investment company, investment adviser, and broker-dealer examinations conducted from fiscal years 2003 through 2006 found that examiners generally follow OCIE's exit procedures for communicating deficiencies to registrants and providing written notice of the examination's outcome, except in an estimated 9 percent of investment company and investment adviser examinations where OCIE directed examiners to forgo these procedures. These examinations were part of a series of OCIE examinations that probed specific activities across a number of firms and were initiated in response to the widespread unlawful trading practices which had surfaced at that time. In addition, GAO estimated that in 7 percent of broker-dealer examinations, either examiners did not follow exit procedures or OCIE officials were not able to provide evidence that they did.

OCIE has implemented several initiatives since January 2006 intended to improve communication with registrants and other aspects of the examination program. For instance, OCIE established a hotline for registrants to receive comments or complaints, began requiring examiners to contact registrants when examinations extend past 120 days, and implemented tools and protocols designed to reduce duplicating examinations. GAO's review indicated that examiners generally complied with the new requirement to notify registrants when an examination extends past 120 days. Comments from industry representatives on OCIE's initiatives suggested some concerns about the hotline. Specifically, several registrants questioned the independence of the hotline, as it is located within OCIE, and said that as a result they would hesitate to use it.