



Highlights of [GAO-08-33](#), a report to the Ranking Member, Committee on Finance, U.S. Senate

Why GAO Did This Study

Self-regulatory organizations (SRO) are exchanges and associations that operate and govern the markets, and that are subject to oversight by the Securities and Exchange Commission (SEC). Among other things, SROs monitor the markets, investigate and discipline members involved in improper trading, and make referrals to SEC regarding suspicious trades by nonmembers. For industry self-regulation to function effectively, SEC must ensure that SROs are fulfilling their regulatory responsibilities. This report (1) discusses the structure of SEC's inspection program for SROs, (2) evaluates certain aspects of SEC's inspection program, and (3) describes the SRO referral process and evaluates SEC's information system for receiving SRO referrals. To address these objectives, GAO reviewed SEC inspection workpapers, analyzed SEC data on SRO referrals and related investigations, and interviewed SEC and SRO officials.

What GAO Recommends

GAO's recommendations to the SEC Chairman for enhancing SRO oversight include, among others, establishing a written framework for conducting SRO inspections, expanding the use of SRO internal review products, and enhancing information technology to improve SEC's ability to track and analyze SROs' implementation of inspection recommendations and SRO referral data. SEC agreed with the recommendations and is taking steps to address them.

To view the full product, including the scope and methodology, click on [GAO-08-33](#). For more information, contact Richard J. Hillman at (202) 512-8678 or hillmanr@gao.gov.

SECURITIES AND EXCHANGE COMMISSION

Opportunities Exist to Improve Oversight of Self-Regulatory Organizations

What GAO Found

To help ensure that SROs are fulfilling their regulatory responsibilities, SEC's Office of Compliance Inspections and Examinations (OCIE) conducts routine and special inspections of SRO regulatory programs. OCIE conducts routine inspections of key programs every 1 to 4 years, inspecting larger SROs more frequently, and conducts special inspections (which arise from tips or the need to follow up on prior recommendations or enforcement actions) as warranted. More specifically, OCIE's inspections of SRO surveillance, investigative, and disciplinary programs (enforcement programs) involve evaluating the parameters of surveillance systems, reviewing the adequacy of policies and procedures for handling the resulting alerts and investigations, and reviewing case files to determine whether SRO staff are complying with its policies and procedures.

GAO identified several opportunities for SEC to enhance its oversight of SROs through its inspection program. First, although examiners have developed processes for inspecting SRO enforcement programs, OCIE has not documented these processes or established written policies relating to internal controls over these processes, such as supervisory review or standards for data collection. Such documentation could strengthen OCIE's ability to provide reasonable assurances that its inspection processes and products are subject to key quality controls. Second, OCIE officials said that they focus inspections of SRO enforcement programs on areas judged to be high risk. However, this risk-assessment process does not leverage the reviews that SRO internal and external auditors performed, which could result in duplication of SRO efforts or missed opportunities to direct examination resources to other higher-risk or less-examined programs. OCIE officials told us that they plan to begin assessing SRO internal audit functions in 2008, including the quality of their work products, which would allow OCIE to assess the usefulness of these products for targeting its inspections. Finally, OCIE currently does not formally track the implementation status of SRO inspection recommendations; rather, management consults with staff to obtain such information as needed. Without formal tracking, OCIE's ability to efficiently and effectively generate and evaluate trend information, such as patterns in the types of deficiencies found or the implementation status of recommendations across SROs, or over time, may be limited.

SEC's Division of Enforcement uses an electronic system to receive referrals of potential violations from SROs. These referrals undergo multiple stages of review and may lead Enforcement to open an investigation. From fiscal years 2003 to 2006, SEC received an increasing number of advisories and referrals from SROs, many of which involved insider trading. However, SEC's referral receipt and case tracking systems do not allow Enforcement staff to electronically search all advisory and referral information, which may limit SEC's ability to monitor unusual market activity, make decisions about opening investigations, and allow management to assess case activities, among other things.