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Office of Inspector General
Office of Audits

OCIE Regional Offices' Referrals to Enforcement



March 30, 2011
Report No. 493



OFFICE OF THE
INSPECTOR GENERAL

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

MEMORANDUM

March 30, 2011

To: Carlo V. di Florio, Director, Office of Compliance Inspections and Examinations (OCIE)
Robert Khuzami, Director, Division of Enforcement

From: H. David Kotz, Inspector General, Office of Inspector General (OIG) *MDK*

Subject: *OCIE Regional Offices' Referrals to Enforcement, Report No. 493*

This memorandum transmits the U.S. Securities and Exchange Commission OIG's final report detailing the results of our audit on OCIE regional offices' referrals to the Division of Enforcement. This audit was conducted as part of our continuous effort to assess management of the Commission's programs and operations and as a part of our annual audit plan.

The final report contains seven recommendations which if implemented should strengthen oversight of the enforcement referrals process in the SEC's regional offices. OCIE and Enforcement concurred with all seven recommendations. Your written response to the draft report has been included in Appendix V.

Within the next 45 days, please provide the OIG with a written corrective action plan to address the recommendations that were made to your respective units. The corrective action plan should include information such as the responsible official/point of contact, timeframes for completing required actions, and milestones identifying how you will address the recommendations that are cited in the report.

Should you have any questions regarding this report, please do not hesitate to contact me. We appreciate the courtesy and cooperation that you and your staff extended to our auditor during this audit.

Attachment

cc: Kayla J. Gillan, Deputy Chief of Staff, Office of the Chairman
Luis A. Aguilar, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
Diego T. Ruiz, Executive Director, Office of the Executive Director
Lorin Reisner, Deputy Director, Division of Enforcement
John Walsh, Chief Counsel, Office of Compliance Inspections and Examinations

OCIE Regional Offices' Referrals to Enforcement

Executive Summary

Background. The mission of the Office of Compliance Inspections and Examinations (OCIE) is to conduct and coordinate the nationwide examination program for entities over which the U. S. Securities and Exchange Commission (SEC or Commission) has regulatory authority. These include broker-dealers, investment advisers, investment companies, transfer agents, nationally recognized statistical rating organizations, clearing agencies, and self-regulatory organizations (SRO).

While conducting inspections and examinations, OCIE staff review the books and records of regulated entities, conduct interviews with management and firm employees, and analyze the entities' operations.¹ One goal of the examination or inspection is to determine if the registrant is in compliance with federal securities laws and regulations.² When examination staff identify noncompliance with securities laws or internal control weaknesses, the registrant is generally provided with a deficiency letter asking that it take steps to remediate the deficiencies, and requesting that it provide a written response. When the registrant's noncompliance or internal control failures are considered serious, such as when OCIE staff believe that investor funds or securities are at risk, the staff may refer the matter to the Division of Enforcement (Enforcement). Enforcement then determines whether to investigate the matter further and, ultimately, whether to recommend an enforcement action to the Commission.³ Each year, cases against regulated entities constitute a significant portion of the Commission's enforcement actions.⁴ Many of these cases are derived from the examination program's referrals to Enforcement.⁵ Examinations of broker-dealers may also be referred to the appropriate SRO for further investigation.⁶

On March 31, 2010, the SEC OIG issued a Report of Investigation entitled *Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme* (OIG Investigative Report No. 526). The OIG found that the SEC's Fort Worth regional office had been aware since 1997 that Robert Allen Stanford was likely operating a Ponzi scheme. The investigation also discovered that after a series of OCIE examinations of Stanford Group Company (Stanford's registered investment advisor) in which each examination

¹ *Examinations by the Securities and Exchange Commission Office of Compliance Inspections and Examinations*, February 2010, p.12.

² *Id.*

³ *Id.*, p.18.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

concluded that the likelihood of a Ponzi scheme or similar fraud existed, the SEC's Fort Worth Enforcement unit did not take significant action to investigate or stop such expected fraud until late 2005. The OIG investigation found that SEC-wide institutional influences within Enforcement did factor into its repeated decisions not to undertake a full and thorough investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing. The OIG investigation found that senior Fort Worth officials perceived that they were being judged on the numbers of cases they brought, so-called "stats," and communicated to the Enforcement staff that novel or complex cases were disfavored. As a result, cases like Stanford, which were not considered "quick-hit" or "slam-dunk" cases, were not encouraged.

On September 22, 2010, the U.S. Senate Committee on Banking, Housing, and Urban Affairs held a hearing on the SEC's investigation and response to Robert Allen Stanford's alleged Ponzi scheme. The Committee heard testimony from SEC officials about the Stanford matter and sought information concerning the steps the agency was taking to prevent future financial frauds and restore investor confidence. Then-Committee Chairman Christopher J. Dodd (D. Conn.) expressed concern that there may be other instances in which Enforcement did not pursue cases identified by regional office examiners because of the perception that SEC headquarters in Washington was only interested in stats and "quick hit" cases.⁷ Chairman Dodd asked the Inspector General, "[W]ere there other matters that are now showing up nationwide that were, quote, 'novel or more complex cases'...that were not brought, because they were novel or complex and did not fit into that...slam dunk or quick hit?"⁸ Chairman Dodd requested that the SEC OIG conduct a review to determine if the concerns about the Fort Worth Regional office found in the OIG's Stanford report also existed in other SEC regional offices.

Objectives. The overall objective of the audit was to determine whether and to what extent OCIE examiners were frustrated in matters other than Stanford where Enforcement did not pursue cases identified by examiners in the SEC's regional offices. Other audit objectives were the following:

- Determining if Enforcement has taken appropriate and sufficient action to address referrals received from OCIE examination staff in the SEC regional offices.
- Determining if problematic trends exist where appropriate action was not taken based on an OCIE referral and where improvements are needed and best practices can be identified to enhance the OCIE examination referral process in the SEC regional offices.

⁷ U.S. Congress, Senate, Committee on Banking, Housing and Urban Affairs, *Oversight of the SEC Inspector General's Report on the "Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme" and Improving SEC Performance*; Sep. 22, 2010, Federal News Service, Inc. (Lexis-Nexis), p. 11.

⁸ *Id.*

Prior OIG Audit Report. The OIG’s last audit of OCIE referrals to Enforcement was conducted in 2001 (*Compliance Inspection and Examination Referrals to Enforcement*, Audit No. 322, issued June 28, 2001). The OIG found that referrals by OCIE to Enforcement were generally efficient and effective. A number of recommendations were made in the report to enhance the referral process, including improving OCIE’s communication with Enforcement, the interested divisions (i.e., Trading and Markets [formerly Market Regulation], Investment Management, and Corporation Finance), and the alleged violator. The OIG found that all of the recommendations from Audit No. 322 had been closed based on our review of the Audit Recommendation Tracking System (ARTS).⁹

Results. The OIG found that examiners across the SEC regional offices are generally satisfied with their Enforcement attorney counterparts. For example, the OIG found through a survey of all OCIE examiners throughout the SEC’s regional offices that most survey respondents indicated that they are either “completely satisfied” or “somewhat satisfied” with actions taken by Enforcement in response to examination-related referrals. Specifically, the OIG found that when combining the responses for “completely satisfied” and “somewhat satisfied” for respondents, the majority of SEC regional offices had a combined level of satisfaction ranging from 70 to 87 percent.¹⁰ We further found that where there was dissatisfaction with the referral process, the level of concern dramatically dropped over time and particularly in fiscal year 2010, with some respondents identifying the newly created Asset Management Unit in Enforcement as having significantly assisted with the acceptance rate of OCIE referrals.

We also found that the large majority of examiners do not believe that Enforcement will only take referrals that involve high dollar value amounts and can easily be brought against the violator. In addition, many of the survey participants who did believe that Enforcement was particularly concerned with dollar thresholds or “stats” noted that this approach was more evident in the past, “prior to Madoff.”

The OIG audit did find certain aspects of the referral process that could use improvement. We found that OCIE sometimes presents referrals informally to Enforcement prior to proceeding with the formal referral process. As a result, there is a concern that not all referral-worthy matters may be captured. We also found that internal concerns over incentives and metrics with regard to the

⁹ The OIG found that during the prior audit, a recommendation was made for an interface between the STARS and CATS2000 tracking systems used by OCIE and Enforcement, respectively. During the fieldwork for this audit, the OIG found that an interface still does not exist between STARS and CATS2000. The OIG found that after the prior audit was completed, the Division of Enforcement launched another case tracking system called the HUB, which currently does not have the ability to interface with STARS.

¹⁰ The OIG provided Enforcement and OCIE management with information concerning specific situations where OCIE examiners had serious concerns that Enforcement action was unsatisfactory, particularly where they believed that there was ongoing wrongdoing, for further review and appropriate action.

percentage of OCIE referrals being accepted by Enforcement may have led OCIE senior officials to request that a particular referral not be captured in the Tips, Complaints and Referrals (TCR) system to avoid the risk of having large numbers of outstanding referrals. We also found that the level of communication between OCIE and Enforcement after a referral is not always consistent in the regional offices. As a result, a number of examiners expressed that they are unaware of the current status of referrals they provided to Enforcement. Further, OCIE and Enforcement use different systems to track referrals, and those systems do not currently interface with each other. In addition, while the SEC established a Home Office Enforcement Referral Review Committee to serve as an integral part of the oversight of the referrals process, the lack of full cooperation from some regional offices limited its ability to bring more transparency and consistency to Enforcement decisions to pursue referrals.

Summary of Recommendations. This report recommends the following:

1. OCIE and Enforcement should carefully review the information provided from the OIG survey regarding the situations where OCIE examiners expressed serious concerns that Enforcement action was unsatisfactory, particularly where the examiners believed there was ongoing wrongdoing, and take appropriate action, including, potentially reversing previous Enforcement decisions, as necessary.
2. OCIE and Enforcement should take appropriate actions to enforce the policy in all regional offices that all OCIE referrals be made in writing using the standard Enforcement Referral Cover Memorandum or an equivalent record as appropriate in light of the new TCR system and other programmatic changes.
3. OCIE should issue policy or guidance requiring OCIE examiners in regional offices to formally refer all significant matters to Enforcement, not merely the matters that Enforcement has already decided to accept.
4. OCIE should take appropriate actions to enforce its policy in all regional offices that all OCIE referrals be uploaded into the TCR system regardless of whether Enforcement has accepted the referral.
5. OCIE should ensure that all referrals currently in the Super Tracking and Reporting System (STARS) are appropriately and adequately updated with the information in the Home Office Enforcement Referral Review Committee spreadsheet.
6. OCIE and Enforcement should continue their efforts to establish a complete interface between STARS or its equivalent, the HUB, and the TCR system.

7. OCIE and Enforcement should determine what will be the future of the Home Office Enforcement Referral Review Committee. If the Committee will not continue, they should ensure that its responsibilities are carried out by another office or group that will continue to oversee the referral process and track outstanding referrals in a meaningful way.

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Background and Objectives

Background

The mission of the Office of Compliance Inspections and Examinations (OCIE) is to conduct and coordinate the nationwide examination program for entities over which the U.S. Securities and Exchange Commission (SEC or Commission) has regulatory authority. These include broker-dealers, investment advisers, investment companies, transfer agents, nationally recognized statistical rating organizations, clearing agencies, and self-regulatory organizations (SRO). OCIE has examination staff located in Washington, D.C., New York, Boston, Philadelphia, Chicago, Denver, San Francisco, Los Angeles, Miami, Atlanta, Fort Worth, and Salt Lake City.¹¹

While conducting inspections and examinations, OCIE staff review the books and records of regulated entities, conduct interviews with management and firm employees, and analyze the entity's operations.¹² One goal of the examination or inspection is to determine if the registrant is in compliance with federal securities laws and regulations.¹³ When examination staff identify noncompliance with securities laws or internal control weaknesses, the registrant is generally provided with a deficiency letter asking that it take steps to remediate the deficiencies and provide a written response. When the registrant's noncompliance or internal control failures are considered serious, such as when the staff believes that investor funds or securities are at risk, the staff may refer the matter to the Division of Enforcement (Enforcement). Enforcement then determines whether to investigate the matter further and, ultimately, whether to recommend an enforcement action to the Commission. Each year, cases against regulated entities constitute a significant portion of the Commission's enforcement actions. Many of these cases are derived from the OCIE examination program's referrals to Enforcement. Examinations of broker-dealers may also be referred to the appropriate SRO for further investigation.¹⁴

As shown in table 1, OCIE has provided over 1,100 examination-related referrals over the past five years, from fiscal year (FY) 2006 through FY 2010. The total number of examination referrals in each FY ranged from 198 in FY 2008 to 272 in FY 2010.

¹¹ *Examinations by the Securities and Exchange Commission Office of Compliance Inspections and Examinations*, February 2010, p. 1.

¹² *Id.*, p.12.

¹³ *Id.*

¹⁴ *Id.*, p. 18.

Table 1: OCIE Regional Offices' Referrals to Enforcement (FY 2006–FY 2010)

Region	Grand Total	FY2010	FY2009	FY2008	FY2007	FY2006
ARO	103	22	20	24	26	11
BRO	108	26	20	28	13	21
CHRO	148	32	27	27	26	36
DRO	66	15	13	5	12	21
FWRO	91	18	18	13	29	13
HQ	41	9	3	2	5	22
LARO	109	25	26	27	14	17
MIRO	78	26	17	19	7	9
NYRO	263	58	60	39	50	56
PLRO	31	9	4	6	5	7
SFRO	85	26	23	7	17	12
SLRO	25	6	6	1	5	7
	1148	272	237	198	209	232

Source: OCIE.

STARS Enforcement Referrals Examination Report. The Office of Inspector General (OIG) found that OCIE keeps track of its referrals in the Super Tracking and Reporting System (STARS), a computerized tracking system, and generates a referrals report that contains such information as the examined entity, lead examiner, matter under inquiry (MUI) opened date, MUI number, and comments related to the status of the referral.

Examination Referrals Process. On November 8, 2006, OCIE and Enforcement issued joint guidance for the processing and tracking of examination-related referrals.¹⁵ The memorandum emphasized the importance of ensuring that a record existed for all examination referrals that were either accepted or declined by Enforcement (or accepted and later closed) and the reasons why Enforcement accepted or declined the examination referral. The memorandum covered the following aspects of the referrals process:

Making a Referral. The memorandum stated that referrals from examinations to Enforcement are generally made via a memorandum from examination staff (generally at the assistant or associate level) to Enforcement staff (generally to the associate, or to the deputy directors of Enforcement in headquarters) and should be made using the standardized *Enforcement Referral Cover Memo*. The memorandum stated that Enforcement and examination staff should discuss the referral, including its strengths and weaknesses, any novel or unique issues, and whether the violation is one that should be highlighted to the industry. The memorandum also encouraged consultation with staff in the Division of Investment Management (IM) and Division of Market Regulation (now the

¹⁵ Memorandum for Field Office Heads and Associates for Enforcement and Examinations, *Tracking Examination Referrals and Investigations Generated from Referrals*, Nov. 8, 2006.

Division of Trading and Markets [TM]) for insight on referrals involving novel fact patterns and/or applications of the law.

Regional Office Referral Committees. The memorandum stated that all regional offices should establish referral committees consisting of at least one senior examination staff member and one senior Enforcement staff member, with additional membership roles assigned as needed.¹⁶ The memorandum stated that regional office referral committees would have the responsibility of assessing and tracking the status of referrals made from the office's examination staff to the office's Enforcement staff. Additional responsibilities of the regional office referral committees would include ensuring that Enforcement and examination staff systems contain consistent and accurate information about the status or disposition of open referrals and discussing the status of examination referrals previously made to Enforcement and potential examination referrals.

Accepting Referrals. The memorandum stated that at the time Enforcement accepted a referral from the examination unit, the Enforcement supervisor or attorney should communicate with the examination staff making the referral to inform them that the referral was accepted. Additionally, the Enforcement staff person should provide the following information to the examination staff person:

- whether an MUI or investigation has been opened (including the date the MUI or investigation was opened and MUI or investigation number);¹⁷
- a list of Enforcement contacts assigned to the MUI or investigation and their telephone numbers.

Following receipt of this information, the examination staff member should update STARS with the MUI or investigation number and Enforcement contact information. In the event a MUI or investigation is opened at a later date, Enforcement staff should provide the examination staff with the updated information so the examination staff can update STARS. In situations where the local Enforcement group is unable to pursue the referral due to resource constraints, Enforcement staff should work with senior management to identify another Enforcement group to pursue the referral. The Enforcement staff should notify the examination staff of the other Enforcement group that will investigate the referral, as well as

¹⁶ The memorandum provided that one useful function the referral committees could provide was to discuss from an Enforcement perspective the types of referrals that are likely to be investigation or result in an Enforcement recommendation to the Commission.

¹⁷ Upon receipt of a referral, the Enforcement attorneys will generally open a Matter under Inquiry (MUI) which may subsequently lead to an investigation. In certain instances, Enforcement may proceed by opening a formal investigation and bypassing the MUI stage.

provide the information described above, so the examination staff can update STARS.¹⁸

Memorandum. The memorandum stated that in instances where the Enforcement staff determined that a referral does not warrant opening a MUI or decide not to pursue a referral beyond the MUI stage, the Enforcement staff should prepare a brief memorandum explaining the declination or closing. This memorandum should be provided to the referring examination staff, as well as to the Home Office Enforcement Referral Review Committee,¹⁹ whose goal was to examine trends in the examination referrals process. The committee was to review referrals where the reason for not pursuing a referral was based on resource constraints and to determine if assignment to another Enforcement office or group was possible.²⁰

Timing. The memorandum provided that decisions on whether to pursue a referral must be made within 60 days of the referral. If a decision is made not to investigate the referral, a memorandum describing the reasons for not pursuing the referral should be prepared and sent to the relevant review committee(s), with a copy to examination staff who made the referral, within 30 days after the decision to decline or close the matter. In a case where an examination referral is declined, the memorandum should be sent to the examination staff no later than 90 days after the date of the referral.

The memorandum further stated that it was the policy of examination staff to send a deficiency letter in all examinations. However, if Enforcement staff have concerns about the possibility of destruction of documents or other such issues, they can request that a deficiency letter not be sent. In such instances, communication with examination staff should occur promptly upon receipt of the referral.

Closing and Investigation. The memorandum noted that occasionally a closing memorandum prepared in connection with an investigation resulting from a referral focuses on the issues tackled in an investigation but does not reference the possible violations that gave rise to the referral. To address this issue, the memorandum directed that closing memoranda be sent to the referring examination staff and the Home Office Enforcement Referral Review Committee, and should address the essential points of the referral.

¹⁸ Currently, the Office of Market Intelligence (OMI) should update the TCR system to reflect the reassignment.

¹⁹ The Home Office Enforcement Referral Review Committee consisted of two interdivisional committees to review referrals from the examination program to Enforcement (one for broker-dealer/transfer agent referrals and one for investment advisor/investment company referrals).

²⁰ Based on testimonial evidence from discussions with management.

SEC OIG’s Stanford Report of Investigation. On March 31, 2010, the SEC OIG issued a report of investigation entitled *Investigation of the SEC’s Response to Concerns Regarding Robert Allen Stanford’s Alleged Ponzi Scheme* (OIG-526). The OIG found that the SEC’s Fort Worth regional office had been aware since 1997 that Robert Allen Stanford was likely operating a Ponzi scheme. The investigation also discovered that after a series of OCIE examinations of the Stanford Group Company (Stanford’s registered investment advisor) in which each examination concluded that the likelihood of a Ponzi scheme or similar fraud existed, the SEC’s Fort Worth Enforcement unit did not take significant action to investigate or stop such potential fraud until late 2005. The OIG investigation found that SEC-wide institutional influences within Enforcement did factor into its repeated decisions not to undertake a full and thorough investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing. The OIG investigation found that senior Fort Worth officials perceived that they were being judged on the numbers of cases they brought, so-called “stats,” and communicated to the Enforcement staff that novel or complex cases were disfavored. As a result, cases like Stanford, which were not considered “quick-hit” or “slam-dunk” cases, were not encouraged.

U.S. Senate Banking Committee Hearing. On September 22, 2010, the U.S. Senate Committee on Banking, Housing, and Urban Affairs held a hearing on the SEC’s investigation and response to Robert Allen Stanford’s alleged Ponzi scheme. The committee heard testimony from SEC officials about the Stanford matter and sought information concerning the steps the agency was taking to prevent future financial frauds and restore investor confidence. Then–Committee Chairman Christopher J. Dodd (D. Conn) expressed concern that there may be other instances in which Enforcement did not pursue cases identified by regional office examiners because of the perception that SEC headquarters in Washington was only interested in stats and “quick hit” cases.²¹ Chairman Dodd asked the Inspector General, “[W]ere there other matters that are now showing up nationwide that were, quote, ‘novel or more complex cases’...that were not brought, because they were novel or complex and did not fit into that...slam dunk or quick hit?”²² Chairman Dodd requested that the OIG conduct a review to determine if the concerns noted in the OIG Stanford report in the Fort Worth regional office existed in other SEC regional offices.

Objectives

The overall objective of the audit was to determine whether and to what extent OCIE examiners were frustrated in matters other than Stanford where

²¹ U.S. Congress, Senate, Committee on Banking, Housing, and Urban Affairs, *Oversight of the SEC Inspector General’s Report on the “Investigation of the SEC’s Response to Concerns Regarding Robert Allen Stanford’s Alleged Ponzi Scheme” and Improving SEC Performance*, Sep. 22, 2010, Federal News Service, Inc. (Lexis-Nexis), p. 11.

²² *Id.*

Enforcement did not pursue cases identified by examiners in the SEC regional offices. Other audit objectives were the following:

- Determining if Enforcement has taken appropriate and sufficient action to address referrals received from OCIE examination staff in the SEC regional offices.
- Determining if problematic trends exist where appropriate action was not taken based on an OCIE referral and where improvements are needed and best practices can be identified to enhance the OCIE examination referral process in the SEC regional offices.

Findings and Recommendations

Finding 1: In Response to the OIG Survey Issued to OCIE Staff, Most Examiners Expressed Satisfaction With Enforcement

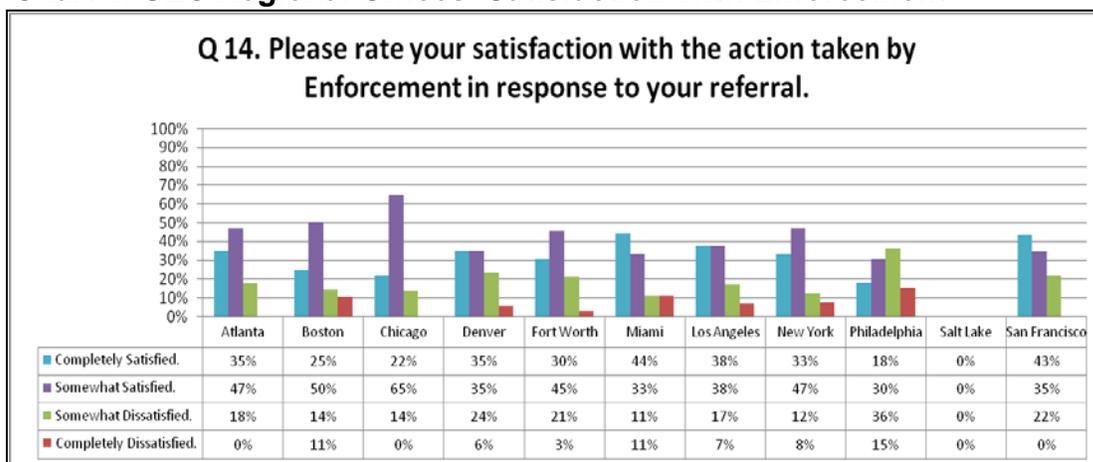
The majority of examiners expressed satisfaction with how Enforcement handled their examination referrals.

In order to elicit information concerning whether and to what extent OCIE examiners in regional offices were frustrated that Enforcement was not pursuing their examination referrals adequately, the OIG sent an electronic survey to OCIE examiners in SEC regional offices concerning their level of satisfaction with actions taken by Enforcement upon receiving examination referrals. The survey was also intended to determine if examiners felt that a heavy emphasis on statistics and “quick hit” cases might be influencing whether or not Enforcement attorneys in their respective regional offices accepted referrals from the examination unit. The OIG launched its survey on November 19, 2010, sending it to over 700 OCIE staff in SEC regional offices. The survey was deployed for a two-week period that ended on December 3, 2010. During this period, a total of 446 respondents began the survey and 337 (75.6 percent) completed it. The OIG survey had 23 questions, including several open-ended questions that allowed respondents to comment freely about a variety of issues related to the Enforcement referrals process. Notable survey results are summarized in this section.

Examiners in Regional Offices Are Generally Satisfied With Enforcement.

The OIG survey found that examiners across the SEC regional offices are generally satisfied with their Enforcement attorney counterparts. For example, the OIG found that the majority of regional office’s survey respondents indicated that they are either “Completely Satisfied” or “Somewhat Satisfied” with actions taken by Enforcement in response to examination-related referrals. As shown in chart 1, the OIG found that when combining the responses for “Completely Satisfied” and “Somewhat Satisfied” for respondents, the majority of SEC regional offices had a level of satisfaction ranging from 70 to 87 percent.

Chart 1: SEC Regional Offices' Satisfaction With Enforcement



Source: OIG.

The OIG found a strong level of general satisfaction with Enforcement's responses. Some examiners, however, expressed dissatisfaction in particular instances about Enforcement's declining a referral or, in their view, taking too long to make a decision. We received several comments expressing this view, including the following two:

Generally, I have been very satisfied with Enforcement's response to referrals. However, it's disappointing when a referral ultimately is not pursued.

[I'm] generally satisfied as most referrals are taken or at least seriously considered. However, investigative action is sometimes slow and does not always result in Enforcement action. Also, in a couple instances, informal referrals were declined.

The OIG also found that some respondents believed that Enforcement declined their referral due to increased litigation risk because the examination-related referral was considered very complex and highly technical or because the amount of investor harm was too small.

Other respondents indicated that a lack of support from within the SEC's policy-making divisions (the Division of Investment Management and the Division of Trading and Markets) for the examination referral might have led Enforcement not to accept the referral. This perspective was reflected in the following comments from respondents:

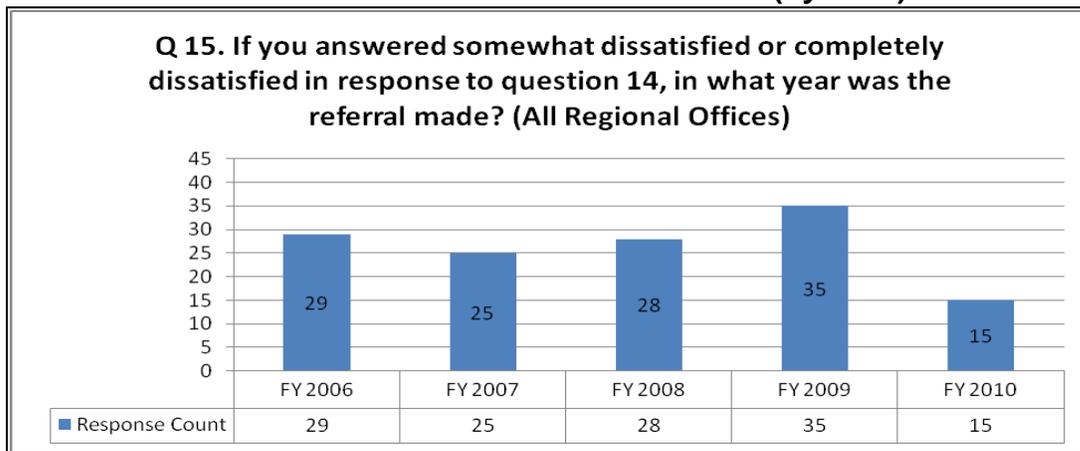
We are constantly told by OCIE and IM staff that valuation is a risk area, yet when we see valuation issues at a firm we don't get backing or support from IM Chief Counsel's office

and/or Enforcement to properly investigate.

Enf is still working the matter. We provided good evidence, local enf agreed, conferred with Investment Management in DC who initially supported the case but then changed their mind about what evidence it would take to get approval for formal action. The case has languished since.

We requested that respondents who were dissatisfied (either somewhat or completely) with Enforcement to indicate the year during which the dissatisfaction occurred. The majority of these respondents indicated dissatisfaction during the period FY 2006 through FY 2009. As shown in chart 2, for each FY from 2006 through 2009, 25 to 35 respondents indicated that they were dissatisfied with Enforcement concerning referrals made during that year. This number dramatically dropped for FY 2010, with only 15 respondents indicating that they had experienced dissatisfaction during that year.

Chart 2: Examiners Dissatisfied With Enforcement (by Year)



Source: OIG.

Respondents Indicated That the New Asset Management Unit Is More Likely to Accept Referrals. According to survey respondents, one of the factors that has recently helped with Enforcement’s acceptance rate of referrals is the division’s newly created Asset Management Unit. Enforcement created the Asset Management Unit in 2010. The unit focuses on investigations involving investment advisors, investment companies, hedge funds, and private equity funds.²³ Some examiners indicated that the Asset Management Unit is more willing to take on referrals that were typically denied in the past. For example, one respondent stated the following:

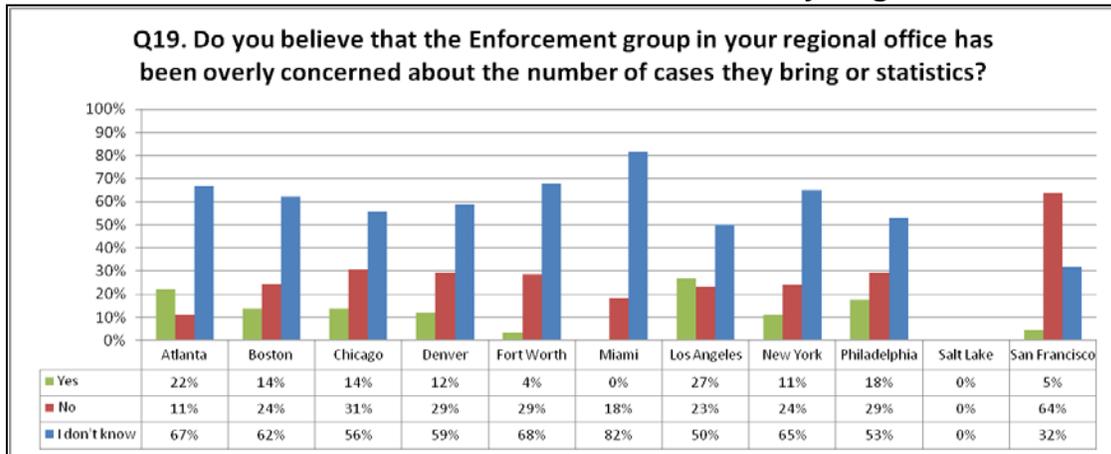
Some exams are not referred because of real and/or perceived Enforcement resource constraints. There are

²³ SEC Release No. 2010-5; “SEC Names New Specialized Unit Chiefs and Head of New Office of Market Intelligence.” See <http://www.sec.gov/news/press/2010/2010-5.htm>.

exams we would have liked to have referred for recidivist conduct, potentially unsuitable sales to seniors, and lack of compliance program, however, because the lack of client harm or difficulty in proving unsuitable sales to seniors who have signed disclosure forms, referrals are not made. In the past, unless Enforcement was gift wrapped a referral, it was hard to get them to take it...However, this has gotten better since the establishment of the Asset Management group in Enforcement. It would be very beneficial if the exam staff had the power to levy a fine or censure.

Perception That Enforcement Is “Overly Concerned” With Statistics. The OIG found that the large majority of examiners did not know whether or did not believe that Enforcement will only take referrals that involve high dollar value amounts and referrals where a case can easily be brought against the violator. As shown in chart 3, the majority of SEC regional office examiners noted that they did not know whether or did not believe that Enforcement was overly concerned with statistics and the number of cases brought.

Chart 3: Percentage of Examiners Who Believe That Enforcement Is Overly Concerned With the Number of Cases or Statistics, by Regional Office



Source: OIG.

Some survey participants did believe that Enforcement had been particularly concerned with dollar thresholds in the past. For example, one respondent stated the following:

Prior to Madoff they were concerned by the number of cases brought. Now, there are so many, they do not need to worry about this "stat." The driving force behind deciding to bring an action continues to be whether the action merits additional resources or whether there is too much "litigation risk."

In addition, some survey respondents indicated that certain types of violations and fraud schemes are easier for Enforcement to pursue. For example, we received the following comment:

Sometimes it appears that Enforcement prefers to work cases that can be resolved in a shorter amount of time, such as misappropriation and ponzi schemes, and does not like to work regulatory cases that are more difficult to prove – even though these type of cases may have more far reaching impact on the securities industry.

Other respondents indicated that certain actions by management in evaluating performance of attorneys has set the foundation in their mind that statistics are the primary metric used to gauge performance and that management may reverse quantity over quality. For example, one respondent stated the following:

While our office seems to espouse that it is quality over quantity that counts, every year the summary reports emphasize statistics - # of MUI, # of actions, # of TROs... They even go so far as to break it down by # of actions per attorney] and other such stats to demonstrate their efficiency. To improve these stats they have to focus on simple, open and shut cases.

Differing Missions of OCIE and Enforcement. Through discussions with management, the OIG discovered that sometimes tension may arise in the referrals process due to the differing missions and focuses of OCIE and Enforcement. Specifically, OCIE focuses its efforts on assessing whether SEC registrants are in compliance with securities laws, while Enforcement's mission is to protect investors and the markets by investigating potential violations of securities laws and litigating the SEC's enforcement actions.²⁴ In many cases, the compliance and examination function may not identify outright fraud but will find indicators that fraud or serious violations exist. Some examiners have expressed the view that where there are indicators but no outright evidence of an existing fraud, Enforcement may be reluctant to pursue the matter and investigate if it might be difficult to quickly recapture funds for harmed investors.

Some examiners also stated that examination staff may feel pressure to identify deficiencies because they believe that OCIE puts a heavy emphasis on the number of significant findings. The pressure may be originating from use of a risk-based examination approach that targets riskier firms for examination, which in theory would produce more findings and deficiencies. For some respondents, this has increased the risk that some referrals may be underdeveloped and of lesser quality. For example, one respondent stated the following:

²⁴ Securities and Exchange Commission, Division of Enforcement, *Enforcement Manual*, Office of Chief Counsel, February 8, 2011, p. 1.

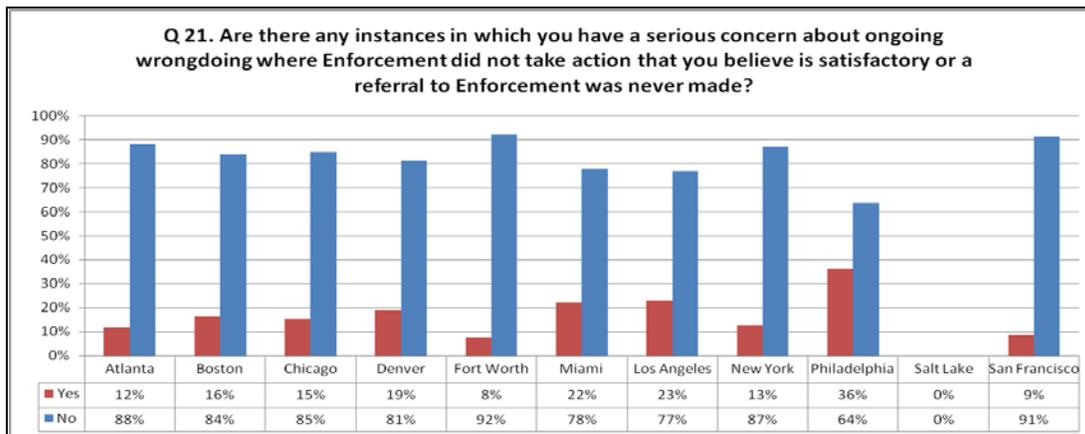
All of management is overly focused on statistics. That's why Examiners are pushed to refer cases that are undeveloped and Enforcement is pushed to take only those cases that will quickly and easily result in a case. Anything overly complex is problematic because we don't have the time or the resources to conduct a proper review.

Similarly, the following respondent expressed a concern about the quality of OCIE referrals to Enforcement:

.... I am concerned about the Exam program in my office's focus on Enforcement referrals. It seems exam management has figured out that no one evaluates the quality of the referral made (other than Enforcement saying yes or no). This has led to many matters being referred that probably should not have been. Management just seems concerned with getting more enforcement referrals and not having deference to overall Commission (Enforcement) resources. Overall, this creates a more dysfunctional process. It makes the exam program almost like the "boy who cried wolf" in that management tries to refer everything, no matter how serious the actual issue is. This covers exam management ... and inflates their statistics, at the expense of [jeopardizing] having Enforcement accept a referral when it is an actual significant matter.

Although the survey results overall did not show widespread concern among examiners about Enforcement's review of OCIE referrals, there were instances where examiners expressed dissatisfaction with Enforcement's response to their referrals or with OCIE's failure to make referrals. As shown in chart 4, the percentage of respondents in SEC regional offices who indicated that they had serious concern about ongoing wrongdoing where Enforcement did not take what the examiner believed was satisfactory action or where a referral was never made to Enforcement ranged from 8 to 36 percent.

Chart 4: Percentage of Examiners Seriously Concerned About Ongoing Wrongdoing Where Enforcement Action Was Not Satisfactory or No Referral Was Made



Source: OIG.

While the percentage of examiners who expressed concern were relatively low, it is important for Enforcement and OCIE management to consider the specific situations where OCIE examiners had serious concerns that Enforcement’s action was unsatisfactory or that a necessary referral to Enforcement was not made, particularly where examiners believed there is ongoing wrongdoing. Therefore, on March 3, 2011, the OIG provided senior management in Enforcement and OCIE with a total of 28 detailed comments for additional evaluation and consideration of potential appropriate action.

The OIG’s review of the survey comments did not reveal any situations that the OIG believed warranted an immediate referral to the OIG’s investigative unit. The comments included allegations of wrongdoing by investment advisers, such as habitually overbilling clients, making false statements in SEC filings, denying examiners access to certain required records, and disseminating nonpublic information to outside sources who may have engaged in trading on that information.

Recommendation 1:

The Office of Compliance Inspections and Examinations (OCIE) and the Division of Enforcement should carefully review the information provided from the Office of Inspector General survey regarding the situations where OCIE examiners expressed serious concerns that Enforcement action was unsatisfactory, particularly where the examiners believed there was ongoing wrongdoing, and take appropriate action, including potentially reversing previous Enforcement decisions, as necessary.

Management Comments. Enforcement and OCIE concurred with the recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement and OCIE have concurred with this recommendation.

Finding 2: Because Some Examination-Related Referrals Are Provided Informally, Some Information May Not Be Captured

OCIE sometimes presents referrals informally to Enforcement prior to proceeding with the formal referral process. As a result, there is a concern that some referral-worthy matters may not be captured.

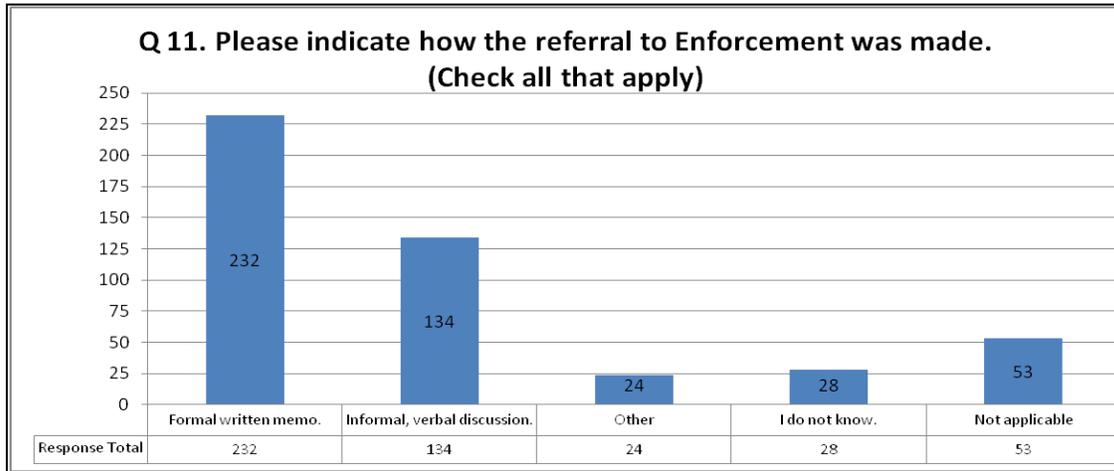
Respondents Indicated that Informal, Oral Referrals Are A Common Occurrence. The standard operating procedures, as codified in the November 2006 internal guidance for providing and tracking referrals issued by the former directors of Enforcement and OCIE, provided that all referrals should be made in writing, using the standard *Enforcement Referral Cover Memo*.²⁵

The OIG asked survey respondents to specify the method used for providing referrals and found, as shown in chart 5, that the majority made their referrals using a formal written memorandum. However, 134 of the respondents indicated that they had made one or more referrals by means of an "informal, verbal discussion" with Enforcement.

During the audit, the OIG selected a sample of 30 examination-related referrals and tested whether the referral was provided in a written, formal memorandum in accordance with Enforcement/OCIE policy. Five of the 30 referrals in our sample did not have evidence that OCIE provided a written referral to Enforcement. An additional 5 of the 30 referrals were provided via e-mail and the standard Enforcement memorandum was not utilized. In several other cases, the only evidence of the referral was the record of the referral listed in the STARS Enforcement Referrals Examinations Report, which is intended to track whether a referral has been accepted or declined by Enforcement.

²⁵ Memorandum for Field Office Heads and Associates for Enforcement and Examinations, *Tracking Examination Referrals and Investigations Generated from Referrals*, November 8, 2006, page 2.

Chart 5: Method Used to Provide Examination-Related Referral



Source: OIG Generated

When a referral is provided orally or through a short e-mail, it may not have all the required pertinent information. Therefore, there is risk that Enforcement will not obtain all the necessary information required to fully analyze the referral and determine if an investigation should be commenced. There is also risk that the referral will not be adequately tracked.

Recommendation 2:

The Office of Compliance Inspections and Examinations (OCIE) and the Division of Enforcement should take appropriate actions to enforce the policy in all the regional offices that all OCIE referrals be made in writing using the standard Enforcement Referral Cover Memorandum or an equivalent record as appropriate in light of the new Tips, Complaints, and Referrals system and other programmatic changes.

Management Comments. Enforcement and OCIE concurred with the recommendation. See Appendix V for management’s full comments.

OIG Analysis. We are pleased that Enforcement and OCIE have concurred with this recommendation.

Finding 3: Some Concerns Exist That Not All OCIE Referrals Are Being Made and Captured in the Tips, Complaints, and Referrals System

The OIG found that management has concerns that not all examination referrals are being captured in the Tips, Complaints, and Referrals (TCR) system. As a result, there is a risk that not all referrals will be tracked in the agencywide TCR system.

The New TCR System. In March 2010, the interim TCR system was launched and has since served as the SEC's repository for all tips, complaints, and referrals, including referrals provided by OCIE to Enforcement.²⁶ Each regional office has a TCR system point of contact responsible for entering referrals into the TCR system. Examination referrals are reviewed for issues or conflicts with current, ongoing Enforcement investigations or actions. However, given its interim state, the system is currently unable to generate all the necessary reports desired by management to determine if referrals were properly handled.

The SEC launched the new TCR system in 2010 with a goal of enabling the newly formed Office of Market Intelligence (OMI) to serve as a "super-user" in reviewing and triaging tips, complaints, and referrals reported to various SEC divisions and offices to identify recidivists and to help assign tips, complaints, and referrals to investigators. OMI was formed to analyze tips according to internally-developed risk criteria as well as SEC priorities, and to utilize the expertise of the SEC's other divisions, offices, and specialized units to help analyze the tips and identify wrongdoing.²⁷ OMI "is responsible for the collection, analysis, and monitoring of the hundreds of thousands of tips, complaints, and referrals that the SEC receives each year."²⁸

High Acceptance Rate May Be Skewed. Although responses to the OIG survey indicated that the most common response or action taken by Enforcement upon receiving a referral from OCIE was the opening of a MUI and a subsequent formal investigation, we found that (1) there is some concern that not all referrals are being made and captured in the TCR system and (2) certain data may be skewed to give the impression that there is a higher acceptance rate for referrals. Further, we found that in some cases referrals are made only after internal, informal discussions between OCIE and Enforcement have determined that the likelihood of acceptance by Enforcement is high. For example, one survey respondent stated the following:

²⁶ Referrals that OCIE provides to an outside SRO (e.g., the Financial Industry Regulatory Authority) are also captured in the TCR system.

²⁷ SEC Press Release 2010-05, *SEC Names New Specialized Unit Chiefs and Head of New Office of Market Intelligence*, January 13, 2010, page 2. See <http://www.sec.gov/news/press/2010/2010-5.htm>.

²⁸ *Id.*, page 1.

This happens on a somewhat regular basis. Our referral acceptance rate is probably quite high because in IA/IC [investment adviser/investment company] regulation, we will only "refer" something after we have talked with Enforcement and they have decided to accept it. For exams that we would like Enforcement to take, but they decide not to, they often just will not be referred and no Enforcement Memo will be written. It would put the exam staff in a better position to refer the exams it deems worthy, and let Enforcement decide to decline the referral if they deem that to be the best course of action. Several exams the staff would like to refer to Enforcement are not brought to Enforcement's attention based on the Associate in Regulation determining that the matter is too small, the harm not large enough, or Enforcement does not have the resources, or some other mitigating factor that does not result in a referral to Enforcement from the Exam staff. There were supposed to be, I believe, regular meetings between Enforcement and Regulation. I do not know whether these occur. There was also supposed to be a group in D.C. that would take cases in the regional office staff did not have resources. I do not know whether this was ever used. A lot of these are judgment calls, but I would like to see us refer exams without an agreement from Enforcement that they will accept it. Rather we should refer what we feel is worthy.

Another respondent stated the following:

In all cases of referrals, I first speak with Enforcement's Associate RD [regional director] who is responsible for considering and assigning referrals. If he is interested, we write up a referral.

Not All Referrals Are Being Captured in the TCR System. The chief of OMI expressed concern to the OIG that not all TCR-worthy referrals are being captured in the TCR system because of the processes in place in various regional offices that may influence which referrals are actually recorded in the TCR system and referred to Enforcement. For example, a regional director may have concern that certain referrals are not going to be accepted by the Enforcement unit due to resource constraints and may request that the referral not be captured in the TCR system to avoid the risk of having large numbers of outstanding referrals. The OMI chief stated that variations in office policies for processing referrals may contribute to certain disparities in the types of referrals being recorded in the TCR system. For example, potential referrals presented orally to a regional referral committee may not reach the TCR system if the committee rejects them and directs that they not be pursued. He further

wondered whether incentives and metrics were appropriate to ensure that TCR-worthy referrals are actually recorded in the TCR system and passed along to Enforcement.

We determined that the TCR system is a work in progress. OCIE now has procedures (issued June 2010) and updated guidance (issued August 2010) for handling and processing examination referrals to Enforcement.²⁹ After completing fieldwork for this audit, the OIG learned that the new TCR Intake and Resolution system was deployed on March 14, 2011.³⁰ The updated policy requires that all referrals to Enforcement from the examinations program be uploaded into the TCR system.³¹ Vetting with local regional Enforcement should not factor into which referrals are loaded into the system.³² However, management remains concerned that the vetting process with regional Enforcement units may be influencing the referrals that are being received by OMI. OMI acknowledges that policies related to the tracking and processing of referrals are in place; however, detailed procedures are needed to ensure that the policies are adhered to by the regional offices. Up to this point, OMI has primarily seen examination referrals provided in the TCR system indicating that the regional Enforcement attorneys have accepted the referral and would like OMI to assign it back to the regional office that submitted the referral. There have been virtually no instances of examination referrals that were submitted to the TCR system that the regional Enforcement units did not take, despite the fact that such denials are common. There has also been a lack of examination referrals provided in the TCR system that have been rejected by Enforcement.

The OIG performed a comparison of the examination referrals in the TCR repository against the examination referrals listed in the STARS Enforcement Referral Report (i.e., the universe of referrals) for FY 2010 to determine whether all referrals identified by the examination staff were forwarded and captured in the TCR system. We found that not all referrals listed in the STARS Enforcement Referral Report were listed in the examination referrals in the TCR system. For example, in the Boston regional office, there were six broker-dealer examination referrals identified from the STARS Enforcement Referral Report. Of the six referrals, only two were found in the TCR system. Additionally, in the Chicago regional office, we found that there were six broker-dealer examination referrals identified from the STARS Enforcement Referral Report. Of the six referrals, only four were entered into the TCR system.

²⁹ OCIE, *Procedures for Handling Tips, Complaints, and Referrals, version 2.0*, June 9, 2010, and Aug. 17, 2010, e-mail from OCIE associate director regarding Enforcement referrals from examination staff and the TCR repository.

³⁰ SEC Administrative Notice: Tips, Complaints and Referrals (TCR) Intake and Resolution System Implementation, Mar. 13, 2011.

³¹ OCIE, *Procedures for Handling Tips, Complaints, and Referrals version 2.0*, June 9, 2010, and Aug. 17, 2010, e-mail from OCIE associate director regarding Enforcement Referrals from examination staff and the TCR repository.

³² Based on testimonial evidence from discussions with management.

Recommendation 3:

The Office of Compliance Inspections and Examinations (OCIE) should issue policy or guidance requiring OCIE examiners in regional offices to formally refer all significant matters to Enforcement, not merely the matters that Enforcement has already decided to accept.

Management Comments. OCIE concurred with the recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OCIE has concurred with this recommendation.

Recommendation 4:

The Office of Compliance Inspections and Examinations (OCIE) should take appropriate actions to enforce its policy in all the regional offices that all OCIE referrals be uploaded into the TCR system regardless of whether Enforcement has accepted the referral.

Management Comments. OCIE concurred with the recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OCIE has concurred with this recommendation.

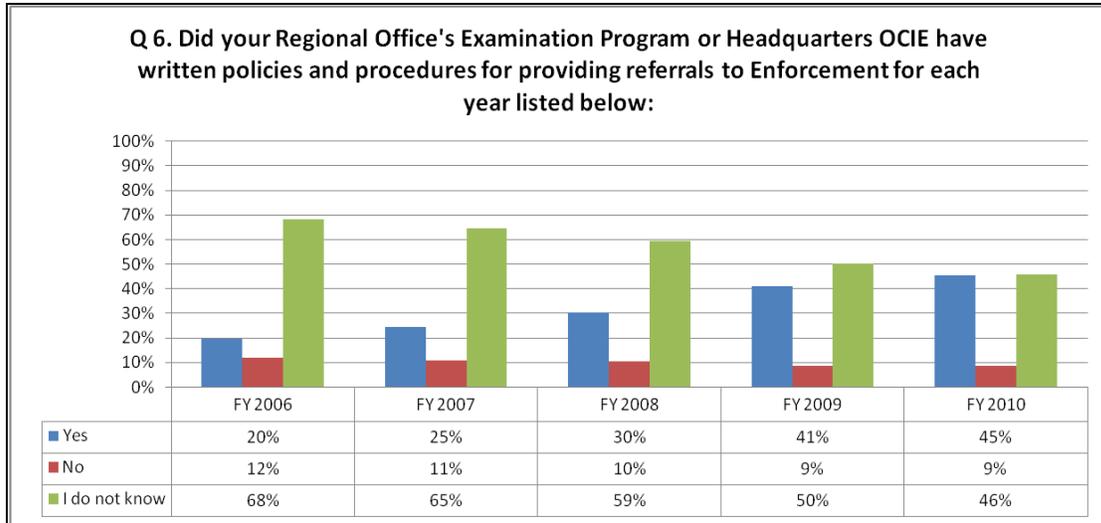
Finding 4: Tracking of Referrals Could Be Improved Through Better Communication and Information Sharing

The level of communication between OCIE and Enforcement after a referral has been provided is not always consistent in the regional offices. As a result, a number of referrals in STARS leave examiners with little information to ascertain the current status of the referral.

Respondents Are Not Aware of Internal Policies and Procedures. The majority of respondents indicated that they did not know if their regional office or OCIE had issued formal, written policies and procedures for handling and processing Enforcement referrals that were provided by the examination staff. As shown in chart 6, our survey data show that 68 percent of the respondents indicated that they did not know whether formal policies existed in FY 2006. Our survey data suggest that there have been some improvements in communicating

internal policies; however, even in FY 2010, almost half of respondents indicated that they were unaware of any formal policies.

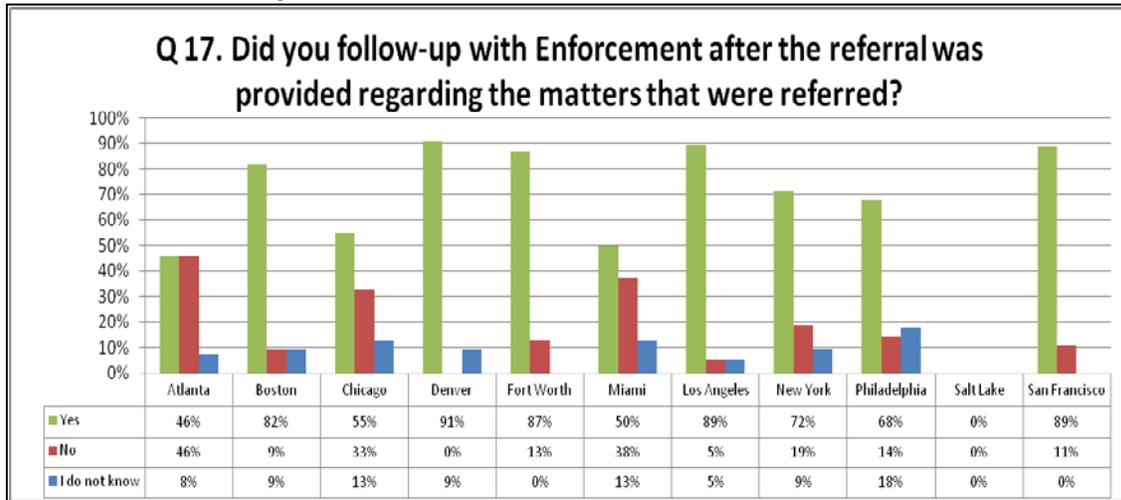
Chart 6: Formal Policies and Procedures for Providing Enforcement Referrals



Source: OIG.

Some Respondents Indicated Their Own Lack of Follow-Up with Enforcement Subsequent to Providing Referrals. The OIG requested survey respondents to indicate if, after providing a referral to Enforcement, they sought information on the status of referrals from Enforcement. The majority of respondents indicated that they reached out to attorneys in Enforcement subsequent to providing referrals; however, we found that there was some disparity at the regional office level. As shown in chart 7, 80 percent or more of respondents in the San Francisco, Los Angeles, Fort Worth, Boston, and Denver offices responded that they followed up after the referral was provided. In contrast, only 45 to 55 percent of examiners in the Atlanta, Chicago, and Miami offices indicated that they followed up with Enforcement subsequent to providing a referral.

Chart 7: Follow-Up With Enforcement After the Referral Was Provided



Source: OIG Generated

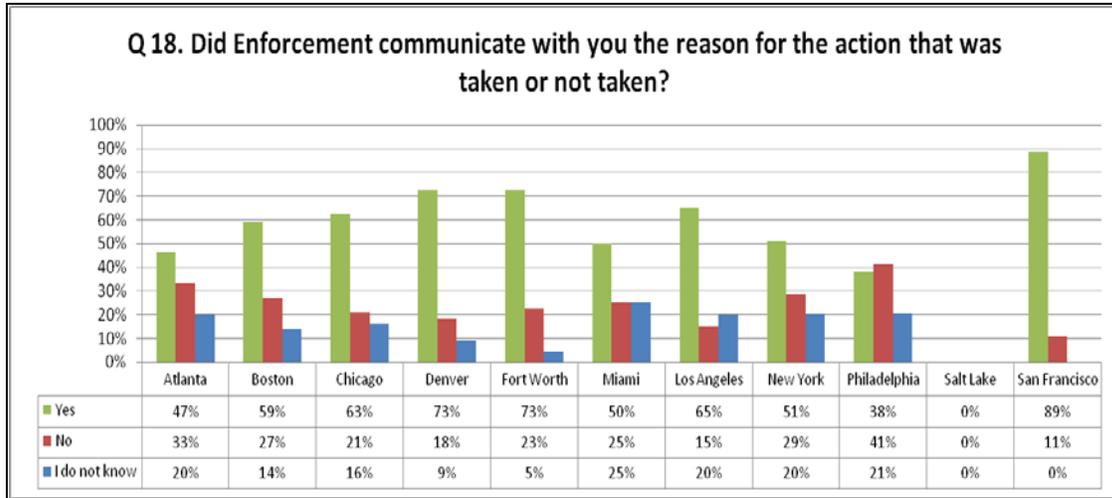
Some survey respondents indicated that they had followed up with Enforcement after providing the referral because Enforcement requested their involvement with the investigation for the referred matter. For example, the OIG learned that some examiners were asked to be involved in legwork for the investigation, including organizing and locating documents, participating in testimony, and answering questions posed by the Enforcement attorneys. However, the OIG found that some respondents expressed frustration in their attempts to connect with Enforcement to gather information on the status of referred matters. A number of respondents indicated that communication with attorneys to obtain the status of referred matters is limited in their regional office to supervisors and that they are discouraged from communicating directly with Enforcement attorneys.

Respondents Indicated That Enforcement Did Not Always Communicate the Reason for Actions Taken or Not Taken. A sizable number of respondents indicated that they were unaware of the reason for actions taken or not taken by Enforcement upon receiving an examination referral; however, there was a considerable disparity across the regional offices. For example, while more than 70 percent of survey respondents in the San Francisco, Denver, and Fort Worth regional offices stated that Enforcement communicated the reasons for actions taken or not taken upon receiving the examination referral, approximately 50 percent or less of respondents in the Atlanta, Miami, New York, and Philadelphia regional offices stated that Enforcement provided the reasoning behind its actions related to the referral.

In addition, based on testimonial evidence obtained from select survey respondents, we found that in some cases, decisions to refer or not refer matters to Enforcement were made by senior-level examiners; however, line-level examiners who worked on the examinations that identified potential matters for referral to Enforcement were not informed of the reasons behind actions taken or not taken in response to the matters referred.

As shown in chart 8, the majority of respondents indicated that there was communication from Enforcement regarding the reason for actions taken or not taken. However, we found there was a wide disparity in responses to this survey question among the regional offices. For example, 89 percent of the respondents in the San Francisco office indicated that Enforcement communicated its reasons for actions taken or not taken upon receiving the referral, while only 38 percent of the respondents in the Philadelphia office acknowledged that such communication occurred for matters referred.

Chart 8: Enforcement Communications for Actions Taken or Not Taken



Source: OIG Generated

Lack of Interface Between OCIE and Enforcement Systems. OCIE and Enforcement use different systems to track referrals, and these systems currently do not interface with each other. Our audit found that the examiners keep a repository of their referrals in STARS and that Enforcement tracks its investigations in its HUB system. STARS contains information about all referrals provided to Enforcement, but it does not always include the status of the referral. The HUB system only includes the status of referrals for matters that have been accepted by Enforcement and when an MUI or investigation has been opened. Thus, examiners who do not have access to the HUB are unaware of the current status of their referrals.

Enforcement recently launched the new TCR system, which now serves as the agencywide repository for tips, complaints, and referrals, including those provided by the examination function. We were informed that there are plans to create an interface between OCIE’s examination tracking system, the HUB, and TCR.

Recommendation 5:

The Office of Compliance Inspections and Examinations should ensure that all referrals currently in STARS are appropriately and adequately updated with the information in the Home Office Enforcement Referral Review Committee spreadsheet.

Management Comments. OCIE concurred with the recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that OCIE has concurred with this recommendation.

Recommendation 6:

The Office of Compliance Inspections and Examinations and the Division of Enforcement should continue their efforts to establish a complete interface between STARS or its equivalent, the HUB, and the TCR system.

Management Comments. Enforcement and OCIE concurred with the recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement and OCIE have concurred with this recommendation.

Finding 5: The Home Office Enforcement Referral Review Committee Had Limited Success in Fulfilling Its Mission

The Home Office Enforcement Referral Review Committee was established as an integral piece of the overall oversight of the referrals process; however, the lack of full cooperation from some regional offices limited its ability to bring more transparency and consistency to Enforcement decisions to pursue referrals.

Home Office Enforcement Referral Review Committee. The Home Office Enforcement Referral Review Committee was established with the initial goal to examine trends in the examination referrals process.³³ The committee consisted of senior staff from OCIE, Enforcement, IM, and TM. Subsequent to the issuance of guidance for tracking referrals issued on November 8, 2006, a

³³ Based on testimonial evidence from discussions with management.

reconciliation process to track referrals was established. Toward the end of 2007 and in the beginning of 2008, the reconciliation of outstanding referrals began on a quarterly basis.

The process started with the generation of a STARS report that identified all new examination referrals for each regional office since the last quarter. OCIE staff on the Home Office Enforcement Referral Review Committee looked through the STARS report for referrals where information (e.g., Enforcement assignee, MUI number) indicated that the referral was outstanding and had not yet escalated to the point of a formal, ongoing investigation. The information from the STARS report was exported into an Excel file and separated in worksheet tabs for each regional office. The information compiled in the spreadsheet was subsequently handed off to the Home Office Enforcement Referral Review Committee so that it could follow up with the regional office to obtain a status update on the referrals. Enforcement requested the regional offices to provide information on the status of the referrals, which often consisted of printouts of the status report from the HUB, declination memoranda or closing memoranda, an Excel spreadsheet created by the regional offices, or an e-mail summarizing the status of the referrals identified for the regional office in the reconciliation.

If a declination memorandum was provided from the regional office, the members of the Home Office Enforcement Referral Review Committee examination team would analyze the content and substance of the memorandum to assess the reasonableness of the decision to decline the referral. In certain instances, if the committee believed that the explanation did not appear to justify a declination of a referral, the committee would provide the declination memorandum to Enforcement to facilitate further consideration. Enforcement's reasons for declining referrals ranged from dollar values associated with the securities violations that did not merit the use of Enforcements resources, uncertainties regarding jurisdiction over the parties or issues involved in the matter, or existence of an ongoing examination or investigation by another party (an SRO or U.S. Attorney's office) of a party or issue identified in the referral.

OIG Compliance Testing Results. The OIG selected 30 referrals from OCIE's examination referrals report and tested for compliance with the internal procedures for handling and tracking referrals. We found that upon initial review of the information in the STARS Enforcement Referral Report and other supporting documents received for each referral in our sample, we were unable to ascertain the current status of 10 of the 30 referrals in our sample because no MUI number or Enforcement investigation number was listed in the STARS Enforcement Referral Report or we did not receive a declination memorandum indicating that Enforcement had declined the referral. Staff from OCIE and Enforcement researched the referrals in our sample for which we were initially unable to ascertain the current status and provided additional information to the OIG, including the associated MUI number and HUB case report for the referrals that had lead to investigations (both active and closed) and a current status

update for referrals that were declined, externally referred, or pending acceptance by Enforcement.

Further, we tested whether declined referrals were sent to the Home Office Enforcement Referral Review Committee for possible reassignment to another SEC regional office if the reason stated for declining by the regional Enforcement unit was limited resources.³⁴ The OIG found no instances where such referrals were sent to the Home Office Enforcement Referral Review Committee for reassignment due to resource constraints.

The OIG also tested whether referrals were sent to the Home Office Enforcement Referral Review Committee for possible subsequent review for declined referrals related to investment advisor/investment company examinations. We found that with the exception of those from the Atlanta office, no declination memoranda were provided to the Home Office Enforcement Referral Review Committee for review.³⁵

A Number of Outstanding Referrals Still Exist. Home Office Enforcement Referral Review Committee members observed disparity in the level of detail provided by regional offices. Only a few regional offices that provided declination and closing memoranda to the Home Office Enforcement Referral Review Committee on a regular basis. The staff identified Atlanta as an example of a regional office that did provide frequent updates on the status of referrals. However, the large majority of regional offices did not provide declination or closing memoranda to the Home Office Enforcement Referral Review Committee on a regular basis.

The OIG found that no referral updates had been received from the New York regional office or the Los Angeles regional office.³⁶ The OIG also found that a number of the regional offices had referrals listed in the spreadsheet dating back to 2007 that did not have a status indicating whether or not the referral was accepted by Enforcement. For example, the OIG found that the New York regional office had seven referrals from Examinations occurring in 2008 that did not indicate whether the referral had been accepted, declined, or referred externally. The longer that these referrals remain outstanding with no update regarding the outcome, the greater the risk that securities violations or fraud

³⁴ See Memorandum for Examination and Enforcement Program Managers, Communications About Enforcement Referrals, July 31, 2007. This memorandum stated that when referrals are declined due to a lack of resources, efforts should be made to locate another Enforcement group to handle the referral and that the new regional referral committees should facilitate these communications. It also encouraged the regional office committees to communicate directly with the relevant headquarters Enforcement referral review committee whenever there might be a close call.

³⁵ From review of the log of declination memoranda reviewed by the Home Office Enforcement Referral Review Committee, the OIG found that a total of only two memoranda were reviewed in 2006, five were reviewed in 2007, six were reviewed in 2008, three were reviewed in 2009, and two were reviewed in 2010. The overwhelming majority that were reviewed were from the Atlanta Regional Office.

³⁶ The OIG also obtained the September 2009 reconciliation and noted that updates were provided in previous reconciliations by the Los Angeles Regional Office and the New York Regional Office.

could continue to persist without an investigation being initiated to bring action against such violations or fraud.

In addition, few formal meetings of the Home Office Enforcement Referral Review Committee regarding the reconciliation occurred in the last year.³⁷ In November 2010, OCIE issued guidance stating that declination memoranda would no longer be required since the TCR system would capture the reasons a referral was declined.³⁸

Recommendation 7:

The Office of Compliance Inspections and Examinations and the Division of Enforcement should determine what will be the future of the Home Office Enforcement Referral Review Committee. If the committee will not continue, they should ensure that its responsibilities are carried out by another office or group that will oversee the referral process and track outstanding referrals in a meaningful way.

Management Comments. Enforcement and OCIE have concurred with the recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement and OCIE have concurred with this recommendation.

³⁷ We understand that a successor committee to the Home Office Enforcement Referral Review Committee that includes OCIE and Enforcement staff meets regularly to discuss OCIE referrals to Enforcement..

³⁸ E-mail dated Nov. 29, 2010, from OMI to OCIE assistant director regarding "Policies on OCIE referrals to Enforcement."

Acronyms/Abbreviations

Enforcement	Division of Enforcement
IM	Division of Investment Management
MUI	Matter under Inquiry
OCIE	Office of Compliance Inspections and Examinations
OIG	Office of Inspector General
OMI	Office of Market Intelligence
SEC or Commission	Securities and Exchange Commission
SRO	Self-Regulatory Organization
STARS	Super Tracking and Reporting System
TCR	Tips, Complaints, and Referrals
TM	Division of Trading and Markets

Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We determined that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Scope. Our scope for this audit covered all examination referrals provided by the regional examination function to regional Enforcement for the period from FY 2006 through FY 2010. Our audit did not include a review of referrals provided by OCIE (examination headquarters in D.C.). Our audit covered information contained in the examination unit's STAR system and Enforcement's HUB system and TCR system to gain an understanding of referrals provided by the examination unit to the Enforcement unit. Our audit included distributing a survey to staff employed in OCIE in SEC regional offices. The survey requested their responses concerning referrals provided to Enforcement for the period from FY 2006 through FY 2010. The OIG launched its survey on November 19, 2010, sending it to over 700 OCIE staff in SEC regional offices. The survey was deployed for a two-week period and closed on December 3, 2010. During this period, a total of 446 respondents began the survey and 337 (75.6 percent) of employees completed the survey. The OIG survey consisted of 23 questions. We conducted our fieldwork from October 2010 to February 2011.

Methodology. To accomplish our overall audit objective of determining whether and to what extent OCIE examiners were frustrated in matters other than Stanford, we obtained and reviewed policies for providing and tracking examination referrals that were issued jointly by OCIE and Enforcement. Additionally, to determine if Enforcement has taken appropriate and sufficient action to address referrals received from OCIE examination staff in the SEC's regional offices, we identified the universe of examination referrals provided to Enforcement for the period FY 2006 to FY 2010 and selected a sample for testing compliance with Enforcement's policies and procedures for handling referrals from the examination unit. To meet the objective of determining if examiners were frustrated in matters other than the Stanford case and to ascertain whether problematic trends existed where appropriate action was not taken based on an OCIE referral, we launched an electronic survey to elicit feedback from OCIE examiners in SEC regional offices to determine the level of satisfaction with actions taken by Enforcement upon receiving referrals from the examination function. The survey was also intended to determine if examiners felt that Enforcement attorneys in their respective regional office were concerned that heavy emphasis on statistics and quick hit cases might be influencing whether or not Enforcement accepted referrals from the examination function.

We further followed up on responses we received from the survey by contacting the survey respondents.

Internal Controls. During our audit, the OIG reviewed internal controls that related to our audit objectives. The OIG obtained OCIE's summary of key internal supervisory controls and reviewed management's internal assessment of its key controls and activities. The OIG found that management did not identify any significant deficiencies in internal supervisory controls as of September 30, 2010.

Use of Computer-Processed Data. We relied on information contained in the STARS Enforcement Referral Examinations Report as the universe of OCIE referrals in SEC regional offices. The OIG performed testing of the accuracy of the STARS Enforcement Referral Examination Report by comparing information for a sample of referrals from the report against the referral memoranda, information contained in the associated examination reports, and Enforcement case reports.

Judgmental Sampling. OCIE provided us with a list of all examination referrals generated for the period FY 2006 through FY 2010. The universe of examination referrals totaled 1,148 for all the SEC's regional offices and headquarters. We judgmentally selected 30 referrals from across the SEC regional offices and across the FYs within our scope, excluding the referrals from headquarters for our sample selection. In addition, our selection was made to ensure that referrals were representative of the various entities under OCIE's oversight, such as broker-dealers, investment advisors, investment companies, and transfer agents. Further, we selected a few items in our sample based on examination referrals identified by respondents in our survey distributed to examination staff in SEC regional offices. We did not try to project the results of the referral samples from the regional offices to the entire population, as we did not utilize statistical sampling techniques.

For our comparison of reports in STARS and the TCR system for examination referrals captured and recorded in FY 2010, we examined referrals from 6 of the SEC's 11 regional offices. We did not try to project the results of the referral samples from the regional offices to the entire population, as we did not utilize statistical sampling techniques.

Prior Audit Coverage.

- *Compliance Inspection and Examination Referrals to Enforcement*, OIG Report No. 322, June 28, 2001.

Criteria

Memorandum for Field Office Heads and Associates for Enforcement and Examinations, Tracking Examination Referrals and Investigations Generated from Referrals, November 8, 2006. Internal policy document intended to facilitate the tracking of examination referrals and ensure that there is a record of all examination referrals that are both accepted and declined by Enforcement (or accepted and later closed), and the reasons why.

Office of Compliance Inspections and Examinations (OCIE) Procedures for Handling Tips, Complaints, and Referrals, version 2.0, June 9, 2010.

Internal policy document intended to guide the entering of tips, complaints, and referrals into the Commission's interim TCR system and define the roles and responsibilities of all examination staff with respect to TCRs.

Memorandum for Examination and Enforcement Program Managers, Communications About Enforcement Referrals, July 31, 2007. Internal policy document issued jointly by Enforcement and OCIE concerning communications about Enforcement referrals from examinations.

List of Recommendations

Recommendation 1:

The Office of Compliance Inspections and Examinations (OCIE) and the Division of Enforcement should carefully review the information provided from the Office of Inspector General survey regarding the situations where OCIE examiners expressed serious concerns that Enforcement action was unsatisfactory, particularly where the examiners believed there was ongoing wrongdoing, and take appropriate action, including potentially reversing previous Enforcement decisions, as necessary.

Recommendation 2:

The Office of Compliance Inspections and Examinations (OCIE) and the Division of Enforcement should take appropriate actions to enforce the policy in all the regional offices that all OCIE referrals be made in writing using the standard Enforcement Referral Cover Memorandum or an equivalent record as appropriate in light of the new Tips, Complaints, and Referrals system and other programmatic changes.

Recommendation 3:

The Office of Compliance Inspections and Examinations (OCIE) should issue policy or guidance requiring OCIE examiners in regional offices to formally refer all significant matters to Enforcement, not merely the matters that Enforcement has already decided to accept.

Recommendation 4:

The Office of Compliance Inspections and Examinations (OCIE) should take appropriate actions to enforce its policy in all the regional offices that all OCIE referrals be uploaded into the Tips, Complaints, and Referrals system regardless of whether Enforcement has accepted the referral.

Recommendation 5:

The Office of Compliance Inspections and Examinations should ensure that all referrals currently in STARS are appropriately and adequately updated with the information in the Home Office Enforcement Referral Review Committee spreadsheet.

Recommendation 6:

The Office of Compliance Inspections and Examinations and the Division of Enforcement should continue their efforts to establish a complete interface between the Super Tracking and Review System (STARS) or its equivalent, the HUB, and the Tips, Complaints, and Referrals system.

Recommendation 7:

The Office of Compliance Inspections and Examinations and the Division of Enforcement should determine what will be the future of the Home Office Enforcement Referral Review Committee. If the Committee will not continue, they should ensure that its responsibilities are carried out by another office or group that will continue to oversee the referral process and track outstanding referrals in a meaningful way.

Management's Comments

MEMORANDUM

TO: David Kotz
Inspector General, Office of Inspector General

FROM: John H. Walsh
Associate Director – Chief Counsel, Designated Audit Liaison for the Office of
Compliance Inspections and Examinations *JHW*

CC: Carlo di Florio
Director, Office of Compliance Inspections and Examinations

RE: Office of Compliance Inspections and Examinations' Response to the Office of
Inspector General's Report, *Regional Offices Referrals to Enforcement*

DATE: March 24, 2011

I. Introduction

The Office of Compliance Inspections and Examinations ("OCIE") submits this memorandum in response to the Office of Inspector General's ("OIG") draft report entitled "*Regional Offices Referrals to Enforcement*" ("Report"). Thank you for the opportunity to respond to the Report. Let me also express our appreciation for the professional courtesy extended by you and your staff during the audit.

We are pleased that your audit found that examiners across the SEC regional offices are generally satisfied with their Enforcement attorney counterparts and intend to continue to work with the Division of Enforcement ("Enforcement") to further strengthen our collaboration and coordination.

You have requested that we indicate whether we "concur" or "non-concur" with each recommendation. We "concur" with all of your recommendations. However, one of the recommendations (Recommendation 6) directed to OCIE and Enforcement will require the deployment of significant resources. In this case we have indicated that we agree with the recommendation, but note that it will not be completed until the necessary resources become available. Otherwise, we state that we "concur" and describe how we intend to implement your recommendation.

II. Recommendations Directed to OCIE

Recommendation 1: *The Office of Compliance Inspections and Examinations (OCIE) and the Division of Enforcement should carefully review the information provided from the OIG survey regarding the situations where OCIE examiners expressed serious concerns that Enforcement action was unsatisfactory, particularly where the examiners believed there was ongoing*

wrongdoing, and take appropriate action, including, potentially reversing previous Enforcement decisions, as necessary.

OCIE concurs with this recommendation. We are in the process of reviewing the information provided to us by the Inspector General's Office on March 3, 2011. We have reached out to regional office management, where appropriate, and they have begun to prepare an Action Plan to address the findings and enhance collaboration and coordination between examiners and Enforcement staff. In addition, to address this recommendation, OCIE intends to continue our review of the information provided and anticipates reaching out to Enforcement to discuss the situations provided to us.

Recommendation 2: The Office of Compliance Inspections and Examinations (OCIE) and the Division of Enforcement should take appropriate actions to enforce its policy in all the regional offices that all OCIE referrals be made in writing using the standard Enforcement Referral Cover Memorandum or an equivalent record as appropriate in light of the new TCR system and other programmatic changes.

OCIE concurs with this recommendation and agrees that all OCIE referrals to Enforcement should be made in writing. OCIE's revised TCR policies dated March 8, 2011 implement an equivalent record of reference, in that they state that all examination referrals should be made to Enforcement via the TCR system. Specifically, the policy reads: "[i]f an OCIE examination results in a referral to Enforcement it will be entered into the TCR System..." The policies also state that the TCR will include the examination number, the examination report, and the enforcement referral memorandum (if applicable).

Recommendation 3: The Office of Compliance Inspections and Examinations (OCIE) should issue policy or guidance requiring OCIE examiners in regional offices to formally refer all significant matters to Enforcement, not merely the matters that Enforcement has already decided to accept.

OCIE concurs with this recommendation. We agree that all examination referrals, not just those that Enforcement has already decided to accept, should be referred to Enforcement. OCIE will issue guidance to examination program management highlighting examiners' responsibilities under OCIE's revised TCR policy dated March 8, 2011 to enter all referrals to Enforcement into the TCR system.

Recommendation 4: The Office of Compliance Inspections and Examinations (OCIE) should take appropriate actions to enforce its policy in all the regional offices that all OCIE referrals be uploaded into the TCR system regardless of whether Enforcement has accepted the referral.

OCIE concurs with this recommendation. As noted in our response to Recommendation 2 above, OCIE's current TCR policy provides that all OCIE referrals should be uploaded into the TCR system. OCIE will develop a process to review referrals for compliance with these procedures.

Recommendation 5: *The Office of Compliance Inspections and Examinations should ensure that all referrals currently in the STARS system are appropriately and adequately updated with the information in the Home Office Enforcement Referral Review Committee spreadsheet.*

OCIE concurs with this recommendation. We agree that past referrals currently in the STARS system should be updated with the appropriate MUI or investigation number and contact information (if applicable) currently available in the Home Office Enforcement Referral Review Committee spreadsheet.

With respect to examination referrals to Enforcement, going forward, the TCR system will capture the examination numbers, Enforcement's decision to accept or decline the referral, and if applicable, the MUI or investigation number. The TCR system will be able to track the status of examination referrals that are entered into the system. We will discuss with the Office of Market Intelligence the possibility of creating a report that tracks all outstanding referrals from the examination program.

Recommendation 6: *The Office of Compliance Inspections and Examinations and the Division of Enforcement should continue its efforts and establish a complete interface between the STARS system or its equivalent, the HUB and the TCR system.*

OCIE concurs with this recommendation. Establishing an interface between the STARS system or its equivalent, the HUB, and the TCR system is a priority for OCIE, but will not be completed within this fiscal year due to lack of technology resources. We will continue to work with Enforcement and the Office of Information Technology to establish this interface as resources become available.

Recommendation 7: *The Office of Compliance Inspections and Examinations and the Division of Enforcement should determine what will be the future of the Home Office Referral Review Committee. If the Committee will not continue, they should ensure that the responsibilities are still carried out by another office/group. Such office or group shall continue to conduct oversight of the referral process and track outstanding referrals in a meaningful way.*

OCIE concurs with this recommendation and agrees that a committee formed to oversight the referral process, made up of OCIE and Enforcement staff, would provide a valuable service to the examination program. OCIE and Enforcement have formed a successor committee to the Home Office Referral Review Committee and its members will meet regularly to discuss OCIE referrals to Enforcement. We are working with Enforcement to define the roles and responsibilities of the committee. Additionally, as previously noted, OCIE and Enforcement will be able to track outstanding referrals in the agency's TCR System.



**DIVISION OF
ENFORCEMENT**

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
100 F Street, N.E.
Washington, DC 20549

MEMORANDUM

TO: H. David Kotz, Inspector General, Office of Inspector General
FROM: Robert S. Khuzami, Director (LS)
RE: Division of Enforcement's Response to the Office of Inspector General's Report on Audit No. 493, *OCIE Regional Offices Referrals to Enforcement*
DATE: March 28, 2011

I. Introduction

The Division of Enforcement ("Enforcement") submits this memorandum in response to the draft report of the Office of Inspector General ("OIG") on OIG Audit No. 493 entitled "*OCIE Regional Offices Referrals to Enforcement*" ("Report"). We appreciate the opportunity to respond to the Report.

You requested that our response indicate whether we "concur or do not concur" with the recommendations. Certain of the recommendations are directed only to OCIE. With respect to those recommendations, we therefore defer to OCIE's response, and stand ready to assist OCIE as appropriate. We "concur" with the various recommendations directed to Enforcement.

II. Recommendations Directed to Enforcement

Recommendation 1: The Office of Compliance Inspections and Examinations (OCIE) and the Division of Enforcement should carefully review the information provided from the OIG survey regarding the situations where OCIE examiners expressed serious concerns that Enforcement action was unsatisfactory, particularly where the examiners believed there was ongoing wrongdoing, and take appropriate action, including, potentially reversing previous Enforcement decisions, as necessary.

Enforcement concurs with this recommendation, and is in the process of reviewing the above-referenced information provided by the OIG to OCIE and Enforcement on March 3, 2011. Enforcement anticipates coordinating its review, and any additional work, with OCIE to ensure that we continue to undertake coordinated efforts in response to OCIE referrals to Enforcement.

Recommendation 2: The Office of Compliance Inspections and Examinations (OCIE) and the Division of Enforcement should take appropriate actions to enforce its policy in all the regional offices that all OCIE referrals be made in writing using the standard Enforcement Referral Cover Memorandum or an equivalent record as appropriate in light of the new TCR system and other programmatic changes.

Enforcement concurs with this recommendation and supports the joint policy of OCIE and Enforcement that all OCIE referrals to Enforcement should be made in writing. Enforcement understands that OCIE recently revised its TCR policies, dated March 8, 2011, to state that all examination referrals should be made to Enforcement via the TCR System. The TCR System currently provides a mechanism for examination staff to provide written comments, along with identifying information such as the examination number and report, with each exam referral made to Enforcement.

Recommendation 6: The Office of Compliance Inspections and Examinations and the Division of Enforcement should continue its efforts and establish a complete interface between the STARS system or its equivalent, the HUB and the TCR system.

Enforcement concurs with this recommendation; however we recognize that implementation of a system interface requires extensive information technology resources that the agency currently does not possess. Establishing an interface between the STARS system or its equivalent, the HUB, and the TCR system is a priority for Enforcement, but will not be completed within this fiscal year due to lack of technology resources. We will continue to work with OCIE and the Office of Information Technology to establish this interface as resources become available.

Recommendation 7: The Office of Compliance Inspections and Examinations and the Division of Enforcement should determine what will be the future of the Home Office Referral Review Committee. If the Committee will not continue, they should ensure that the responsibilities are still carried out by another office/group. Such office or group shall continue to conduct oversight of the referral process and track outstanding referrals in a meaningful way.

Enforcement concurs with this recommendation and agrees that a centralized committee comprised of OCIE and Enforcement staff formed to review exam referrals would be of value to the referral process. Enforcement and OCIE are in the process of establishing a successor committee to the Home Office Referral Review Committee. The successor committee will regularly review and discuss OCIE referrals, as well as regional office exam referrals. We are currently working with OCIE to define the roles and responsibilities of the successor committee. We believe that this mechanism for review of examination referrals will enhance the collaboration between OCIE and Enforcement, and assist each division in achieving programmatic goals.

OIG Response to Management's Comments

We are pleased that OCIE and Enforcement have concurred with all of the report's 7 recommendations. We are also pleased that OCIE and Enforcement intend to work together to address the recommendations that require a joint effort for implementation, such as the creation of a system interface between OCIE's STARS application or its equivalent, Enforcement's HUB system, and the TCR system. We encourage OCIE and Enforcement to make available the necessary resources to undertake this effort which will significantly improve information sharing throughout the referrals process. We believe that the swift implementation of all of our recommendations will result in significant improvements to the enforcement referrals process and will ensure that all referral-worthy matters are appropriately captured and tracked.

Once all the recommendations are fully implemented, we believe that the resulting improvements will also help to strengthen oversight of the enforcement referrals process in the SEC's regional offices.

Audit Requests and Ideas

The Office of Inspector General welcomes your input. If you would like to request an audit in the future or have an audit idea, please contact us at

U.S. Securities and Exchange Commission
Office of Inspector General
Attn: Assistant Inspector General, Audits (Audit Request/Idea)
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