

**SEC'S OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS  
PROVIDES A TOP TEN LIST OF CONCERNS AT THE SIA CONFERENCE**

John Walsh, Chief Counsel of the Securities and Exchange Commission's Office of Compliance Inspections and Examinations (the "OCIE") yesterday outlined a list of the top ten areas of concern for broker-dealer inspections and examinations at the Securities Industry Association Compliance & Legal Division Seminar in Palm Desert, California.

The OCIE's list of top 10 items for broker-dealer inspections includes:

1. **Sales practices and suitability.** A number of broker-dealers are emphasizing they are not just salesmen but that they have a holistic approach to providing brokerage services. Hence the OCIE is focusing on how broker-dealers are assessing and implementing suitability of recommendations, in the belief that the brokers "are raising the bar for themselves." (It appears this is essentially a concern about firms making inappropriate recommendations to retail customers through salesmen to whom the firms give titles that connote investment advisory skills and motivations.)
2. **Supervision.** Many firms are moving away from having "producing branch managers." The OCIE is testing through examinations whether this change is having a positive effect on supervisory standards.
3. **Trading on exchange floors and by over-the-counter market makers.** The OCIE is looking at instances where firms are trading ahead of customer orders and at compliance with the Order Handling Rules (Rules 11Ac1-1 and 11Ac1-4 under the Securities Exchange Act of 1934).
4. **Best execution.** The OCIE is looking at best execution practices, focusing on:
  - (a) Conflicts of interest;
  - (b) Soft-dollar practices;
  - (c) Paying through commissions for items other than brokerage and research;
  - (d) Rebates.
5. **Internal control issues within the broker-dealer.**
6. **Net capital and customer reserve compliance.** In 8% of the examinations, the OCIE has found a net capital deficiency and in 18% a computational error. This has caused the OCIE to increase its scrutiny of this area. The OCIE also is looking at the "rent a FinOp" practices that are prevalent among smaller broker-dealers to see how involved the rented FinOp really is in the broker-dealer's financial review and control.

7. **Mark-ups.** There have been a number of “for cause” examinations where clients have complained to the SEC about excessive mark-ups. Mr. Walsh indicated that the TRACE system has been especially helpful in providing data for review of markups.
8. **Anti-money-laundering.** The OCIE has been conducting “full scale” AML reviews.
9. **Information security.** As of July 1, 2005, a broker-dealer's policies and procedures must be in writing. The OCIE will be looking to make sure the broker-dealer has put in place controls to prevent misuse of customer information, particularly trading information.
10. **Sales to the military.** Misrepresentations by registered representatives to military personnel, particularly with respect to products that involve long-term commitments, are a major OCIE focus.

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If you have any questions concerning the OCIE and its inspection process, please contact Roger D. Blanc (212-728-8206, rblanc@willkie.com) or the attorney with whom you regularly work.

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