

MEMO# 7502

December 20, 1995

ADDRESS OF THE SEC'S DIRECTOR OF THE OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS

December 20, 1995 TO: COMPLIANCE COMMITTEE No. 46-95 INVESTMENT ADVISERS
COMMITTEE No. 49-95 SEC RULES COMMITTEE No. 130-95 RE: ADDRESS OF THE SEC'S
DIRECTOR OF THE OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS

Lori Richards,
Director of the Securities and Exchange Commission's Office of Compliance Inspections
and Examinations ("OCIE"), recently addressed the Institute's Securities Law Procedures
Conference on a variety of issues concerning mutual fund and investment adviser
compliance and examinations. A copy of Ms. Richards's address is attached. Ms. Richards
announced the formation of the "Mutual Funds Industry Examination Panel," which will
review the OCIE's new, not yet implemented examination manual, subject it to
independent field tests, and propose improvements. The members of the panel are Henry
Hopkins (T. Rowe Price), Peter Ambrosini (Price Waterhouse), Paul Haaga (Capital Group),
Tom Lemke (Strong Group), Mary Ann Tynan (Wellington Management), Phil Kirstein (Merrill
Lynch Asset Management), Susan Cote (Prudential Advisers), Mark Baltuch (Zweig
Advisers), Joe Carrier (Coopers & Lybrand) and Dan MacLean (Dreyfus). Ms. Richards
announced that the examination manual will be finalized in early 1996. Ms. Richards also
announced several actions taken to improve the efficiency of the operations of the OCIE,
including an increase in staff training, the creation of more cross-disciplinary examination
teams, working to ensure consistency in the approach and disposition of examinations, and
working for improved coordination within the regulatory community. Ms. Richards also
announced that the OCIE has begun coordinating examinations of smaller, local investment
advisers with state regulators by conducting joint sweep examinations of these advisers
and financial planners. The OCIE is working to improve coordination with the regulated
community as well. Ms. Richards stated that the OCIE's examinations should recognize the
"high degree of professionalism and institutional support" in fund compliance departments.
She also stated that the OCIE's examinations should recognize state-of-the-art compliance
systems by not spending too much time reviewing routine operations. She said, "We are
fortunate that your community has a long tradition of honesty . . . We want to encourage
and support your efforts to maintain those high standards." Ms. Richards stated that there
are a few areas in which examiners found problems. First, commission and mark-up dollars
belong to the client and should not pay for the adviser's operating expenses or client
referrals, absent disclosure to clients. She noted that the OCIE "frowns upon" double or
triple billing of operating expenses to soft-dollar brokers. Second, access persons should be
required to file quarterly reports required by Rule 17j-1 on time and their trades should be
reviewed in light of client and fund trades. A fund's board should inquire into the

differences between the adviser's code of ethics and that of the fund. The board should know whom the adviser deems to be covered by each code. Finally, the OCIE has seen some problems with respect to pricing override procedures. Advertised performance should not drop suddenly late in the year when expenses turn out to be much higher than estimated and pricing mistakes should be corrected. Thomas M. Selman Associate Counsel
Attachment

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