

*Mr. Becker*

MEMORANDUM

February 21, 1967

**TO:** Manuel F. Cohen  
Chairman

**FROM:** Irving M. Pollack, Director  
Division of Trading and Markets

**SUBJECT:** Cost Reduction Report for Six Month Period  
Ending December 31, 1966

The Division is responsible for reporting on the following activities on a Commission-wide basis: Improved Market Surveillance, Broker-Dealer Inspections, and Investment Adviser Inspections.

IMPROVED MARKET SURVEILLANCE

In this area the Division is meeting its cost reduction goal.

BROKER-DEALER AND INVESTMENT ADVISER INSPECTION PROGRAMS

In both of these areas, after due allowance for pay rate increases, increased travel costs, and adjustments in our manpower accounting system, a slight increase rather than a decrease in the unit cost of completed inspections is shown.

There are a number of reasons for this increase. These reasons represent factors which have come about subsequent to the original formulation of our goals. These factors, which are enumerated below, will require that we temporarily eliminate the Broker-Dealer and Investment Adviser Inspection Programs as activities under the Cost Reduction Program.

1. Our original cost reduction goals were based on the premise that we would probably continue our policy of random, cyclical inspections during fiscal 1967 even though alternative policy was under consideration. However, after the formulation of the original goals this alternative policy was implemented on a pilot basis in both the broker-dealer and investment adviser areas.

This policy is based on the premise that the Commission should concentrate on inspections for cause and on the examination of particular activities of broker-dealers and investment advisers. The activities on which we plan to concentrate are selling practices and various forms of overreaching and fraud. In the case of investment advisers especial

attention is being given to selling literature and advertisements; this attention has already paid off in the form of a planned proceeding against Dow Theory for misleading advertising. We hope that the NASD will be able to cover adequately the more technical aspects of our previous inspections such as bookkeeping and net-capital violations.

This policy will obviously result in fewer and longer inspections, but, we feel, inspections of greater quality and enforcement value.

2. In an effort to achieve comparability with the NASD, a policy of inspecting an increased number of non-NASD broker-dealers is being followed. The inspections of these broker-dealers require the expenditure of more man-years at this time because we are applying the new inspection procedures developed by our Branch of Non-NASD Regulation. Once our broker-dealer inspections become more familiar with these new procedures, the efficiency of these inspections should improve, but, in any event, they will be somewhat longer than our previous inspections because of the new requirements of SECO rules.

3. Recent and prospective personnel changes in our regional offices, particularly New York and Fort Worth, have and will have the effect of creating a state of flux in our inspection programs in those regions.

4. The Commission is also concentrating on certain specific serious enforcement problems with regard to broker-dealers. The chief of these at the moment is the problem of interpositioning. This concentration has the effect of diverting our more experienced inspectors from their regular work.

In summary, our broker-dealer and investment adviser inspection programs are in a state of re-evaluation and experimentation. Since the innovations described above were instituted relatively recently, we do not have sufficient experience to measure their effectiveness at this time. Hence it will be impossible for the immediate future to formulate meaningful cost reduction goals. Under these circumstances, I recommend that these two activities be temporarily eliminated from the Cost Reduction Program.