

MEMORANDUM

TO: ARTHUR

FROM: CARRIE

DATE: MARCH 9, 1995

SUBJECT: REORGANIZATION

You have asked me to explain the rationale the ad hoc "reorganization group" used to decide to include the SRO examination function in the proposed new office of inspections.

- The group never seriously considered leaving this function out of the new office, since it fits functionally (sales practice and surveillance staffs must interact) and its high profile would be necessary to attract quality staff to an area that might otherwise be seen as "back office" in nature. The entire plan, of course, is premised on having excellent communications between the operating divisions and this "resource" division. The new division would exist to support the operating divisions in their work.

- The perception is that this is an area, like the other examination functions, which could benefit from more professional management, and higher priority resources. Whether it is a resource or management issue, this group has been habitually slow to issue reports of its inspections; the reports when issued, while lengthy, can lack substance and/or appear to be formulaic; there has been criticism of the group's follow-up on the recommendations it makes.

- We have been considering the quality of the work done by the group. NERO's review of NASDAQ trading records previously reviewed by the group and found to show no violations, have provided a number of enforcement referrals and preliminary evidence of systemic issues. The recently aborted inspection of the municipal bond markets had no analysis of any inspection data, but was merely a collection of old news clips and other publicly available statistics, two to three years old. As recently as two months ago, this group was (and still may be) actively asserting that trade reporting in the NASDAQ market was timely and accurate, and attempted to furnish statistics which proved this case. Subsequent analysis has shown these numbers to be incorrect. An unreleased inspection report on backing away asserts that the bulk of the complaints are without merit. The NASD has taken disciplinary action on many of these same cases subsequently, as may we. The Madoff and Instinet inspection reports concluded that the inspections staff lacks the expertise to evaluate whether these systems actually function as they are supposed to.

- We talked about the benefits of splitting inspections from rulemaking and policy, as a management control which could result in the commission receiving more than one source of input about the

state of regulated entities. As you know, it was this group's opposition to looking more closely at NASDAQ which led you to ask Enforcement to take the lead in what really should be this group's job.

- Also in the context of the NASDAQ inspection, we have been considering whether the Commission might gain some benefits from separating the examination function from the rulemaking and policy functions, as a way of providing independent management controls