




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

OFFICE OF THE
INSPECTOR GENERAL

MEMORANDUM

March 17, 2011

To: Carlo V. di Florio, Director, Office of Compliance Inspections and Examinations
Lori J. Schock, Director, Office of Investor Education and Advocacy
Robert S. Khuzami, Director, Division of Enforcement

From: H. David Kotz 
Inspector General

Re: Review of Commission Activities in U.S. Territories and Republics

This memorandum transmits the U.S. Securities and Exchange Commission (SEC), Office of Inspector General report on the activities of the SEC in U.S. territories and republics.

Should you have any questions regarding this report, please do not hesitate to contact me.

Attachment

cc: Kayla J. Gillan, Deputy Chief of Staff, Office of the Chairman
Elisse Walter, Commissioner
Luis Aguilar, Commissioner
Troy Paredes, Commissioner
Mark Cahn, General Counsel

BACKGROUND

The mission of the Securities and Exchange Commission (SEC) is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC's vision is to strengthen the integrity and soundness of U.S. securities markets for the benefit of investors and other market participants, and to conduct its work in a manner that is as sophisticated, flexible, and dynamic as the securities markets it regulates.

The Office of Inspector General (OIG) is an independent office within the SEC that conducts audits of SEC programs and operations and investigations into allegations of misconduct by agency staff and contractors. The mission of the OIG is to detect fraud, waste, and abuse, and to promote integrity, economy, efficiency, and effectiveness in the SEC's programs and operations.

On February 10, 2011, the SEC Inspector General testified before the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. House of Representatives, concerning his oversight of the SEC vis-à-vis the OIG's audit and investigative functions. During that testimony, the Inspector General was asked by U.S. Congressman José E. Serrano (D-NY):

What kind of involvement does the SEC have direct physical involvement with the territories? I mean, are there field offices, if you will, in the territories? What is the exchange? And also, you know, one of America's best kept secrets is in addition to territories, we also have associated republics, like Palau and Micronesia, and so on? Is there any involvement with that?

See Transcript of Hearing, Financial Services and General Government Appropriations for 2012, Thursday, February 10, 2011, Securities and Exchange Commission – Inspector General, at p. 47.

The Inspector General replied that he would provide Congressman Serrano with information responsive to his questions and concerns.

As a result of Congressman Serrano's request, the OIG has researched the involvement that the SEC has with respect to U.S. territories and republics and has determined that the following Divisions of the SEC have contact with investors in U.S. territories: the Office of Investor Education and Advocacy (OIEA), the Office of Compliance Inspections and Examinations (OCIE), and the Division of Enforcement (Enforcement).

REVIEW

I. RESPONSIBILITY FOR U.S. TERRITORIES AND REPUBLICS

The SEC has 11 regional offices around the country, in addition to its headquarters office in Washington, D.C. The regional offices that have been assigned specific responsibility for U.S. territories are the Miami Regional Office, which is responsible for the U.S. Virgin Islands and Puerto Rico, and the Los Angeles Regional Office, which is responsible for Guam. We understand that the SEC's headquarters office assumes primary responsibility for all other U.S. territories and republics.

II. OCIE

OCIE administers the SEC's nationwide examination and inspection program for registered self-regulatory organizations, broker-dealers, transfer agents, clearing agencies, investment companies, and investment advisers. OCIE conducts examinations of investment advisers, broker-dealers, and transfer agents in U.S. territories. It also reviews and responds to investor complaints and has fielded complaints from investors located in U.S. territories and from investors outside the territories with respect to subjects located in the territories.

The following table provides data on the number of registrants and number of examinations that OCIE has conducted over the past five years in U.S. territories and republics.

U.S. Territories and Outlying Areas									
<small>source: http://www.usa.gov/Agencies/State_and_Territories.shtml</small>									
	IAs [Principal Place]	Examinations of IAs (FY2006 - present)*	IAs [# of Branch Offices]**	BDs [Principal Place]	Examinations of BDs (FY2006 - present)*	BDs [# of Branch Offices]***	Transfer Agents****	Examinations of TAs (FY2006 - present)*	Investment Companies
Puerto Rico	8	1	15	12	7*****	242	2	3*****	-
Northern Mariana Islands	-	-	-	-	-	1	-	-	-
U.S. Virgin Islands	2	-	1	6	-	9	-	-	-
American Samoa	-	-	-	-	-	-	-	-	-
Guam	2	-	1	1	-	12	-	-	-
Minor Outlying Islands									
<i>Baker Island</i>	-	-	-	-	-	-	-	-	-
<i>Howland Island</i>	-	-	-	-	-	-	-	-	-
<i>Jarvis Island</i>	-	-	-	-	-	-	-	-	-
<i>Johnston Atoll</i>	-	-	-	-	-	-	-	-	-
<i>Kingman Reef</i>	-	-	-	-	-	-	-	-	-
<i>Navassa Island</i>	-	-	-	-	-	-	-	-	-
<i>Palmyra Atoll</i>	-	-	-	-	-	-	-	-	-
<i>Wake Island</i>	-	-	-	-	-	-	-	-	-
Federated States of Micronesia	-	-	-	-	-	-	-	-	-
Midway Islands	-	-	-	-	-	-	-	-	-
TOTALS	12	1	17	19	7	264	2	3	0
Notes -									
*Examination totals are of those firms with principal offices in the locations listed. The staff has also conducted a limited number of examinations of the branch offices listed (preliminary estimates indicate that there have been ~6 BD branch office exams since the beginning of FY2006).									
**Only 7 unique IAs									
***Only 54 unique BDs									
****Neither of these TAs are registered with the SEC. Banco Popular is registered with the Fed and Banco Santander with the FDIC. However, the SEC has joint-examination authority over both TAs.									
*****Respective numbers represents 5 unique BDs and 2 unique TAs.									

The OIG has further found that OCIE conducted a joint broker-dealer/investment advisor examination in December 2010 of a firm located in Puerto Rico. The firm was examined for cause based on the SEC's prior knowledge of the firm's poor compliance controls. The impetus for conducting the cause examination was Enforcement's initiative to bring coordinated enforcement actions against registered investment advisers that have willfully failed to adopt or implement written policies and procedures reasonably designed to prevent, detect, and correct violations of the Investment Advisers Act. When OCIE previously examined the firm five years ago, OCIE found that the firm had very poor compliance controls. In addition, an October 2009 Financial Industry Regulatory Authority review found compliance issues that indicated that the firm still had poor overall compliance controls. During the examination, OCIE examiners found numerous and recidivist deficient practices and confirmed its suspicions that the firm had not developed a robust compliance program since the last examination. OCIE staff had preliminary discussions with Enforcement regarding the examination in January 2011, and provided Enforcement with an outline of issues and supporting documentation in February 2011. The examination report was completed on March 9, 2011. OCIE has informed us that it intends to issue the firm a deficiency letter by the end of March.

III. OIEA

OIEA has three main functional areas: the Office of Policy, which has responsibility for reviewing agency action from the perspective of individual investors; the Office of Investor Advocacy, which responds to questions, complaints, and suggestions from members of the public; and the Office of Investor Education, which carries out the SEC's investor education program.

According to information retrieved from OIEA's Investor Response Information System (IRIS) database, which has captured data since November 2009, the following contacts of OIEA by investors in U.S. territories have occurred during the last 15 months:

- Puerto Rico (25 contacts)
- U.S. Virgin Islands (5 contacts)
- Guam (3 contacts)
- American Samoa (0 contacts)

OIEA also provided the following historical information on contacts from U.S. territories from 2002 to November 2009, when IRIS was instituted:

- Guam (38 contacts)
- American Samoa (2 contacts)
- Federated States of Micronesia (0 contacts)
- Puerto Rico (226 contacts)
- U.S. Virgin Islands (24 contacts)

OIEA indicated that it responded to these complaints in the normal course of business and confirmed that it had responded appropriately to all of the contacts from U.S. territories, many of which were forwarded to Enforcement.

The following are examples of the types of follow-up work that OIEA has completed with respect to contacts from U.S. territories:

Example 1: In November 2009, the Chicago regional office received a phone complaint from an investor in Puerto Rico about a potential offering fraud by an entity that he thought was under SEC investigation. The matter was forwarded to Enforcement.

Example 2: An investor in Puerto Rico asked the SEC staff to investigate claims by the chief executive officer of two non-registered entities that they would be the subject of an initial public offering. These claims allegedly had been made for ten years. The company has changed its name more than once, moved location, and issued new share certificates to its investors. The matter was referred to Enforcement.

Example 3: An investor in Puerto Rico complained that she and her husband were charged account management fees in 2008 and 2009 by a broker-dealer, although their investments had remained with their predecessor financial firm until March of 2008. The SEC contacted the broker-dealer on behalf of the investor and her husband. Although the broker-dealer denied any wrongdoing, it agreed to waive the account management fees for 2010 in the amount of \$595.

IV. ENFORCEMENT

Enforcement assists the SEC in executing its law enforcement function by recommending the commencement of investigations of securities law violations, by recommending that the SEC bring civil actions, and by prosecuting these cases on behalf of the agency. Enforcement has stated that it obtains evidence of possible violations of securities laws from many sources, including investor tips from U.S. territories and republics. Enforcement also regularly conducts investigations involving allegations concerning entities and individuals located in U.S. territories, and certain matters have involved a significant number of investors in U.S. territories. However, a search of the public webpage of Litigation Releases made by Enforcement shows only matters related to Puerto Rico. The public webpage indicates no filed Enforcement actions with significant contacts with American Samoa, Guam, or the U.S. Virgin Islands and no reported Enforcement actions relating to Wake Island, Jarvis Island, the Northern Mariana Islands, Baker Island, Howland Island, or any of the other minor outlying islands.

On March 14, 2011, Enforcement deployed its new Tips, Complaints and Referrals (TCR) Intake and Resolution system to capture and track investor complaints made to the SEC. Enforcement simultaneously launched a TCR website containing links to the TCR Intake and Resolution system policy and procedures, user guide, training material, support information, and points of contact. During this review, Enforcement reported receiving the following TCRs regarding the U.S. territories since 2004:

TCRs Received from Individuals Located in U.S. Territories	
Guam	6
Puerto Rico	18
U.S. Virgin Islands	2

TCRs Received Where Subject Is Located in U.S. Territories	
Puerto Rico	10
U.S. Virgin Islands	5

One example of an action brought by Enforcement involving conduct in a U.S. territory was an August 2009 civil injunctive action against a Florida resident and company for operating a multi-million dollar fraudulent pyramid scheme involving investors from Puerto Rico.

CONCLUSION

The OIG found that while the SEC does not maintain a presence (as in a physical office) in any U.S. territory or republic, it does respond to complaints from the territories and conducts examinations in the territories. The SEC has also filed enforcement actions involving conduct in or related to U.S. territories. Some U.S. territories are assigned to specific regional offices, but many of the territories and all of the republics are not currently assigned to any regional office.

The OIG also found that OIEA has identified investor complaints from the U.S. territories, with over 250 coming from Puerto Rico alone, and that OCIE has conducted examinations of firms located in Puerto Rico.

Based on our review, we suggest that the SEC reinforce the roles and responsibilities of headquarters and the regional offices regarding investor protection in U.S. territories and republics. Furthermore, we suggest that OIEA consider performing investor outreach and education in U.S. territories and republics to ensure that they have the knowledge and opportunity to have their concerns addressed by the SEC.