

**BROKER-DEALER  
INTERNAL CONTROL PROCEDURES  
FOR HIGH YIELD SECURITIES**

**A Report by the  
Division of Market Regulation\*  
U.S. Securities and Exchange Commission**



**October 1993**

***\*Although the Commission has authorized publication  
of this report, it has expressed no view regarding  
the findings or conclusions herein.***



firm's written Chinese Wall procedures, as well as written policies and procedures concerning personal investments by the firm's employees <sup>4</sup> or their immediate family members.

In Section Two of this report, the Division outlines its general findings <sup>5</sup> concerning industry practices in the High Yield market. <sup>6</sup> The Division found that the broker-dealers interviewed have taken a number of measures to strengthen their internal control procedures for High Yield operations. In particular, firms have adopted control procedures for the dissemination of High Yield research reports that may involve material information.

Some firms have sought to address these areas primarily by applying to High Yield operations many of the same Chinese Wall procedures that have been used for years for operations involving equity securities. This was particularly common in firms that have chosen to structure their High Yield research operations along the lines of research operations commonly used for equity securities and to channel more High Yield research into formal, printed (commonly referred to as "glossy") research reports akin to those normally produced for equity research. This operational framework appears to facilitate the application of traditional Chinese Wall procedures.

Other firms have decided to maintain close links between High Yield research and trading/sales operations and to emphasize the rapid development and dissemination of informal, oral research reports for High Yield securities. These firms have determined that the rapid flow of information within the firm and to the firms' institutional customers is essential and that the time required to produce glossy research reports may render the information in the reports stale. Written reports issued by these firms are more in the nature of memorializations of research that had been orally disseminated earlier. These firms have stressed refinements to their procedures to monitor and, in some cases, restrict, their employees' personal trading in High Yield securities.

In addition, some firms have determined that the most practical means of preventing improper trading by employees in High Yield securities (or even the appearance of questionable personal trading) is to impose absolute prohibitions against any personal trading in these securities by High Yield personnel. These firms have determined that, because much of the research (as well as other information sharing within and outside of the firms) is oral and, therefore, difficult to monitor, the application of many of the control procedures that traditionally are used in equity operations would be impractical for operations involving High Yield securities.

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<sup>4</sup> As used throughout this report, the term "employee" includes all personnel at a firm. For those firms structured as partnerships, therefore, this would include the firm's partners.

<sup>5</sup> The Division's review of the firms' operations and procedures was conducted pursuant to the Commission's inspection and examination authority. Many of the firms' records that were provided for this review are proprietary and extremely confidential. As a result, the detailed findings from this review are nonpublic.

<sup>6</sup> Section Two of the report is designed to be descriptive of industry practices and perspectives concerning High Yield operations. These descriptions should not be interpreted as endorsements or criticisms. The Division's determinations regarding broker-dealer control procedures for High Yield operations are provided in Section Three of the report.























