

**2022**

**California Department of  
Financial Protection and Innovation**

# **Broker-Dealer / Investment Adviser Program 2022 Annual Report to the Legislature**

**PROTECTING CONSUMERS**  
FOSTERING TRUST & INNOVATION

**DFPI**   
DEPARTMENT OF FINANCIAL  
PROTECTION & INNOVATION



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PROTECTION & INNOVATION

**Lourdes M. Castro Ramírez, Secretary**

Business, Consumer Services and Housing Agency

**Clothilde V. Hewlett, Commissioner**

Department of Financial Protection and Innovation

**Edgar L. Gill Jr., Senior Deputy Commissioner**

Division of Corporations and Financial Institutions

**Balbiro Kazla, Deputy Commissioner**

Broker-Dealers and Investment Advisers



January 10, 2022

Dear Senators/Assemblymembers:

The Department of Financial Protection and Innovation (DFPI) respectfully submits the attached 2022 Report on the Broker-Dealer/Investment Adviser (BDIA) Program as required by the Budget Act of 2014 and the Supplemental Report of the 2017 Budget Act. Beginning in 2016, pursuant to provisional language in the 2014 Budget Act (Chapter 25, Statutes of 2014), the DFPI must provide the Legislature and Department of Finance an annual report on the BDIA program by January 10 of each year.

Recognizing the need for proper oversight of broker-dealers and investment advisers, the Legislature enacted SB 538 (Chapter 335, Statutes of 2013), which authorized the DFPI to collect annual registration renewal fees from broker-dealers and investment advisers to support regular examination of BDIA Program licensees. Regular and periodic examinations help ensure this industry and its employees adhere to the law and their duties to investors.

Upon authorizing the BDIA Program to spend the revenue from the renewal fees, the Legislature also required annual reporting on the BDIA program. Specifically, this report includes 2020-2021 fiscal year information on the number of positions authorized and filled, the number and share of licensees examined, results and outcomes of examinations, examination program recommendations, and estimated staffing levels required to achieve the targeted examination cycles for licensees.

I hope you find the report informative and useful. Please do not hesitate to contact our Deputy Commissioner of Legislation, Nicole Hisatomi, with questions or concerns. She can be reached by phone at (916) 539-0181 or by email at [Nicole.Hisatomi@dfpi.ca.gov](mailto:Nicole.Hisatomi@dfpi.ca.gov). The report also can be found on the DFPI website at [www.dfpi.ca.gov](http://www.dfpi.ca.gov).

Sincerely,

Clothilde V. Hewlett  
Commissioner  
Department of Financial Protection and Innovation

# Broker-Dealer / Investment Adviser Program 2022 Report to the Legislature

The Broker Dealer/Investment Adviser (BDIA) Program, under the Corporate Securities Law of 1968, licenses and regulates investment advisers, investment adviser representatives, broker-dealers, and broker-dealer agents. Regulatory oversight protects the investing public from unethical and fraudulent activities and ensures California's financial services market is secure, fair, and transparent. The BDIA Program carries out its oversight duties by performing detailed licensing reviews and regulatory examinations of licensees. The following table shows historical numbers of licensees.

## Workload History by Fiscal Year (FY)

Workload Measure	2018-19	2019-20	2020-21
Investment Adviser Firms	3,729	3,743	3,734
Investment Adviser Representatives	55,752	56,685	57,738
Broker-Dealer Firms	2,674	2,618	2,578
Broker-Dealer Agents	294,532	296,366	300,492
Broker-Dealer Branch Offices	16,814	16,740	16,395

### 1. Number of positions authorized and filled

The BDIA Program has a total of 89 authorized positions, and currently 77 of the 89 positions are filled. BDIA is actively recruiting to fill all vacant positions.

### 2. Number and share of licensees examined by fiscal year

The following table shows the number of examinations completed and the percentage of licensees examined from FY 2018-19 through FY 2020-21.

Licensee Type	Number of Licensees			Number of Exams Completed			Percent of Licensees Examined		
	2018-19	2019-20	2020-21	2018-19	2019-20	2020-21	2018-19	2019-20	2020-21
Investment Adviser Firms	3,729	3,743	3,734	1,001*	693**	500***	26.84%	18.51%	13.39%
Broker-Dealer (In-State)	408	407	394	14	16	17	3.43%	3.93%	4.31%
Broker-Dealer (Out-of-State)	2,266	2,211	2,184	0	0	0	0%	0%	0%
Broker-Dealer Branch Offices	16,814	16,740	16,395	51	32	29	0.30%	0.19%	0.17%
<b>Total</b>	<b>23,217</b>	<b>23,101</b>	<b>22,707</b>	<b>1,066</b>	<b>741</b>	<b>546</b>	<b>30.57%</b>	<b>22.63%</b>	<b>17.89%</b>

\*The total Investment Adviser examinations number includes 598 examinations conducted by examination questionnaire.

\*\*The total Investment Adviser examinations number includes 176 examinations conducted by examination questionnaire.

\*\*\*The total Investment Adviser examinations numbers includes 183 examinations conducted by examination questionnaire.

### 3. Results and outcomes of examinations

The BDIA Program completed 546 examinations of broker-dealers, broker-dealer branch offices, and investment advisers in FY 2020-21. Of the total examinations, 183 were done by online examination for investment advisers. In 2018, the DFPI created a streamlined examination process allowing licensees to submit responses through a secure online application. Initially, the examination was sent to all California registered investment adviser firms that maintain their principal place of business in another state (598 examinations for FY 2018-19). Beginning in FY 2019-20, the DFPI began implementing a four-year cycle of staggered examinations for out-of-state licensees. This meant that each year 25% of this population of licensees would be examined, including 176 examinations for FY 2019-20 and 183 examinations for FY 2020-21. Of the 546 total examinations completed, violations were found in 17 of the examinations, which resulted in referrals to the DFPI's Enforcement Division for administrative actions and/or penalties. The remaining 529 examinations identified books and records violations for which the licensees took corrective action by implementing procedures to mitigate future violations.

As a result of the COVID-19 pandemic, the DFPI staff moved to emergency telework in March 2020 and continue to work remotely. Like every other workplace in the country, the global crisis brought challenges to the execution of DFPI's work in a telework environment and DFPI has adapted with its licensees.

Despite the challenges, the BDIA program efficiently and effectively modified its resources and adopted new procedures to keep up with examination efforts. Employees working from home examined licensees through remote desk exams and the program employed video conferencing tools to enhance engagement with licensees during entrance and exit interviews.

Moreover, program staff have been amenable and responsive to the concerns and needs of its licensees in scheduling examinations, providing adequate time to gather books and records, and respond to Department inquiries regarding the examination. Though these times are unprecedented, the DFPI remains committed to its licensees and broader mission to protect consumers through a flexible but dedicated examination process.

Effective Jan. 1, 2020, Chapter 272, Statutes of 2019 (SB 496) expanded the category of mandated reporters of suspected financial abuse to include broker-dealers and investment advisers. The law authorized a broker-dealer or investment adviser who makes a report to notify any trusted contact person who had previously been designated by the elder or dependent adult of any known or suspected financial abuse, and to temporarily delay a requested disbursement or transaction from an account of an elder or dependent adult or an account to which an elder or dependent adult is a beneficiary if specified conditions are met. Existing law makes specified reports, including reports of known or suspected financial abuse of an elder or dependent adult, confidential. Any violation of the confidentiality of these reports is a misdemeanor. SB 496 extended that confidentiality to a report of known or suspected financial abuse of an elder or dependent adult by a broker-dealer or investment adviser. Reports of suspected financial abuse are of such a confidential, serious, and urgent nature that the BDIA must report the known or suspected instance of financial abuse immediately, or as soon as practicably possible, within two working days to the local adult protective services agency, the local law enforcement agency, and the Department.

The enactment of this important law created additional responsibilities for Department staff to review and address these reports in a timely and confidential manner. The Department has expeditiously

coordinated between the mandated reporter, adult protective services agencies, and other law enforcement agencies to protect consumers and comply with the new law.

As a result of the new law, the BDIA Program redirected several staff to review and process confidential reports related to SB 496 issues. From Jan. 1, 2020, when the law became operative, to June 30, 2021, the Department has received and reviewed 699 reports.

The DFPI has regulatory authority and oversight over all state investment advisers, broker-dealers, and broker-dealer branch offices. In addition to DFPI regulation, broker-dealers and branch offices are regulated by the U.S. Securities and Exchange Commission (SEC), the firm's home-state regulators, and the Financial Industry Regulatory Authority (FINRA). FINRA is a private organization that acts as a self-regulatory organization providing oversight over its member brokerage firms by writing and enforcing its rules as well as federal securities rules and laws established by the SEC. FINRA conducts regulatory examinations of its member broker-dealers and broker-dealer branch offices.

Since BDIA is the sole regulatory authority over state-registered investment advisers, the Department has placed a priority on their examination. To fully utilize program resources and maximize consumer protections, the BDIA Program streamlined its work efforts to increase the number of examinations of investment adviser firms. The DFPI focuses its examination efforts on broker-dealer firms located in California to maximize protection of California investors. For broker-dealer firms located outside of California, the DFPI conducts regulatory examinations of branch office locations in California. In addition, the SEC, FINRA, and the firms' home-state regulators also conduct routine examinations of these licensees. To avoid unnecessary duplication of efforts, the DFPI coordinates and works with its federal and state counterparts to examine these entities. The BDIA Program continues to conduct examinations of licensees based on consumer complaints and referrals.

#### **4. Examination program recommendations**

##### **Investment Adviser Firms**

A total of 3,734 investment adviser firms are registered with the DFPI. In order to promote consumer protection, the BDIA Program conducts regulatory examinations of all investment adviser firms using a risk-based approach.

The program has reviewed the scope of its examinations and restructured exam work paper modules to create a more streamlined examination process that can be utilized in a remote environment. The BDIA Program continues to review and refine these modules to conform with changes in the industry. As a result, the quality of examinations has increased to better promote consumer protection. Violations, findings, and regulatory issues are provided to licensees through the issuance of Regulatory Examination Reports. The program will continue to refine and develop its capabilities in examinations.

##### **Broker-Dealer Firms**

A total of 2,578 broker-dealer firms are registered with the DFPI. Of these, 394 have their principal place of business or home office in California. To increase protection of California consumers, the BDIA Program maximizes the efficiency and cost effectiveness of its oversight by prioritizing and conducting regulatory examinations of these 394 firms.

The SEC, FINRA, and other home-state regulators also oversee and conduct routine regulatory examinations of the broker-dealer firms located outside California. The DFPI and FINRA hold quarterly discussions on upcoming exam cycles, trends, significant investigations, and enforcement matters. The DFPI and the SEC also share upcoming exam plans and work together on enforcement matters. The DFPI continues to coordinate with these entities to provide oversight and avoid unnecessary duplication of examinations. The number of broker-dealer firms headquartered in California is used in the calculation of the required number of examiners below.

### Broker-Dealer Branch Offices

The total number of broker-dealer branch offices reported in California is 16,395. The DFPI licenses broker-dealer firms and reporting branch offices as additional offices working under the license of the principal firm. Broker-dealer firms are responsible for supervising all business activities at branch offices and conducting routine on-site branch inspections every 1-3 years.

Broker-dealer firms and their branch offices obtain membership and registration through FINRA, giving FINRA oversight authority to examine the operations of the entities. FINRA conducts routine cycle examinations of broker-dealer firms and their branch offices. To prioritize examinations and avoid unnecessary duplication of branch office examinations, the BDIA Program continues to work with FINRA.

The DFPI has reviewed its options for better focusing its resources and has prioritized examinations of higher-risk branch offices. The following table identifies the level of risk involved at branch locations with associated individuals who have disclosed criminal, regulatory, civil, judicial, or customer complaint events.

The BDIA Program creates an annual branch exam plan to examine branches representing different categories. The program continues to examine branches at all levels of risk based on tips, complaints, and referrals. The number of broker-dealer branch locations determined to be high risk is used to calculate the required number of examiners. This is illustrated in the table below.

<b>Number of Broker-Dealer Branch Locations</b>	<b>Number of Associated Individuals with Disclosures at the identified branch office locations in column 1</b>	<b>Identified Risk Levels</b>
732	3 or more individuals	High risk
724	2 individuals	Medium risk
3,796	1 individual	Low risk
11,143	0 individuals with disclosures	Very low risk
<b>Total: 16,395</b>		



## Calculation of Required Number of Examiners for BDIA Program

	Number of Firms*	Exam Cycle (years)	Estimated Exams Per Year (total DFPI workload)	Average Number of Staff Hours Per Exam	Total Number of Ongoing Workload Hours (DFPI-wide)	Annual Hours Available Per Examiner**	Estimated Total Number of Required Examiners
<b>Investment Advisers</b>	3,734	4	934	80	74,720	1,660	45
<b>Broker-Dealer Firms (In-state)</b>	394	4	99	100	9,900	1,660	6
<b>Broker-Dealer Branch Offices (high-risk)</b>	732	4	183	80	14,640	1,660	9
<b>Totals</b>	<b>4,860</b>		<b>1,216</b>		<b>99,260</b>	<b>1,660</b>	<b>60</b>

\* Number of licensees fluctuates year after year and number of branch office examinations may change based on risk factors.

\*\* Of the total number of position hours (1,760), 1,660 hours are available per examiner with 100 hours needed for formal training.

### 5. Estimated required staffing levels

The BDIA Program has 89 authorized positions for FY 2021-22. Of these positions, 68 are allocated to examinations [56 examiners perform regulatory examinations and prepare audit workpapers, and 12 positions are supervisory and perform reviews of audit workpapers, issue examination reports, manage the corrections of examination findings/violations and review enforcement-related matters]; one position reviews investor complaints and elder abuse reports; nine positions perform licensing reviews and management approval functions; and 11 positions, including the CEA, provide support to the program.

The table below provides a summary of changes in staffing levels since reporting began in January 2017 using the same historical reporting categories used in annual reports.

<b>HISTORICAL REPORTING</b>	<b>2022 Report</b>	<b>2021 Report</b>	<b>2020 Report</b>	<b>2019 Report</b>	<b>2018 Report</b>	<b>2017 Report</b>
Total Staff Authorized	89	89	89	90	82	73
Examination <sup>a</sup>	57	57	57	61	53	47
Licensing	8	8	8	8	8	7
Management and support (includes exam managers)	24	24	24	21	21	19
Number of Examination Staff Needed	60	62	63	63	65	303
Available Examination Staff	56	57	57	61	53	47
Additional Examiners Needed	4	5	6	2	12	256



Recent inquiries prompted DFPI to review and update the reporting categories to provide a more accurate picture. The updated reporting below groups licensing and examination managers with the staff performing that work, instead of in the management and support group, in order to more clearly represent where program resources are allocated.

<b>UPDATED REPORTING</b>	<b>2022 Report</b>	<b>2021 Report</b>	<b>2020 Report</b>	<b>2019 Report</b>	<b>2018 Report</b>	<b>2017 Report</b>
Total Staff Authorized	89	89	89 <sup>b</sup>	90	82	73
Examination (includes exam managers)	68	68	68	69	61	53
Licensing	9	8	8	8	8	7
Complaint and elder abuse review	1	1	1	1	1	1
Leadership and support staff <sup>c</sup>	11	12	12	12	12	12
Number of Examiners Needed to perform examinations	60	62	63	63	65 <sup>d</sup>	256
Available Authorized Examiners	56	56	56	56	56	56
Additional Examiners Needed	4	6	7	7	9	200

a. One of the examiners processes complaints and elder abuse report reviews and historically has been reported on this line

b. Former Commissioner redirected one position to HR [June 2019] to accelerate hiring the newly authorized BDIA positions

c. Ten support staff and one CEA (Deputy Commissioner)

d. The change from needing 256 examination staff to 65 represents the program's re-focus of examining all licensee populations to examining all IA licensees, in-state Broker Dealer licensees and high-risk branch offices, as explained in section 4 of this report.

Based on current information, the BDIA Program estimates it needs at least four additional examiners to meet the target four-year examination cycle for investment adviser firms, broker-dealer firms (in-state) and high-risk broker-dealer branch offices.

<b>Estimated Required Staffing:</b>	
<b>Number of Examination Staff Needed</b>	60
<b>Available Examination Staff</b>	56
<b>Additional Examiners Needed</b>	4

If additional examiners are not authorized, the BDIA Program will continue to prioritize examinations of high- risk firms. The BDIA Program is also considering increasing the length of examination cycles to five years for broker-dealers with home offices in California and 10 years for high-risk broker-dealer branch offices. The BDIA Program has also identified options for increasing efficiencies in its supervision of BDIA licensees. These efficiencies include prioritizing investment adviser examinations, implementing remote exams and exam questionnaires, and checking regularly with the SEC and FINRA to maximize available resources and eliminate exam duplication.

The BDIA Program will continue to participate in quarterly discussions with FINRA on exam strategies and data regarding broker-dealers and broker-dealer branches; will continue to evaluate resource needs; and will report its findings relative to any new considerations and examination results in next year's annual report.



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