

# BROKER-DEALER REGISTRATION PROCESS

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## EXECUTIVE SUMMARY

*We found that the Commission's process for registering broker-dealers is generally effective and in compliance with regulations. We also found communication among the Division of Market Regulation, the Office of Filings and Information Service, the self-regulatory organizations, and state regulators to be effective. SRO staff commended Commission staff on their responsiveness to SRO needs.*

*Certain improvements would enhance this process by ensuring that (1) broker-dealer withdrawals are implemented in 60 days as required by regulation; (2) relevant computer systems are promptly updated when a broker-dealer's registration with the Commission is revoked due to an administrative proceeding; (3) all administrative proceedings are timely recorded on the intranet; (4) data recorded in various databases are accurate and consistent; and (5) written policies and procedures for the broker-dealer registration process are established.*

*Commission officials generally agreed with the report's recommendations and instituted procedures during the audit to address recommendations and concerns brought to their attention. We commend them for their timely responses.*

*The Commission's written comments are included in the appendix of this report.*

## OBJECTIVES AND SCOPE

Our audit objectives were to (1) evaluate the efficiency and effectiveness of the Commission's broker-dealer registration process; (2) determine compliance with applicable laws and regulations; and (3) assess communication among the Division of Market Regulation (MR), the Office of Filings and Information Services (OFIS), the self-regulatory organizations (SROs), and the states.

During the audit, we interviewed Commission staff in MR, OFIS, the Office of the Administrative Law Judges, the Secretary's Office, the Office of Information Technology, and the Office of Investor Education and Assistance. We also spoke with personnel at the New York Stock Exchange, the Boston Stock Exchange, the National Association of Securities Dealers Regulation, and the North American Securities Administrators Association (state securities regulators) to obtain their

views of the Commission's process for registering broker-dealers. We also reviewed documentation and internal controls.

The audit was performed from June to August 2001 in accordance with generally accepted government auditing standards, with one exception. Because of time constraints, we did not evaluate the validity and reliability of data from certain computer systems (*e.g.*, the Central Registration Depository, Workload and the Regulated Entity Database) used in the audit. In our opinion, detailed testing of these computer systems would most likely not have materially affected our findings, in part because much of the data we used were confirmed with knowledgeable Commission staff.

## BACKGROUND

Broker-dealers register with the Commission, an SRO, and a jurisdiction (state) by filing a Form BD through the Central Registration Depository (CRD) operated by the National Association of Securities Dealers (NASD). The form contains information on the applicant's background, controlling persons, principals, and employees.

OFIS staff review the form for completeness, and compare the application's disclosures to data in the Name Relations Search Inquiry (NRSI) database and the CRD. They enter information about the status of the firm into CRD, which in turn daily updates two Commission mainframe systems: Workload, a database of all Commission filings, and the Regulated Entity database, which contains broker-dealer information.

After its review and data entry, OFIS grants registration by issuing an effective order conditioned on SRO approval. By regulation, Commission review takes no more than 45 days.

The SRO performs a more extensive review than the Commission's, with a time frame of 180 days.<sup>1</sup> Once the broker-dealer becomes a member of an SRO, the Commission approves the application by updating CRD.

The state(s) in which the broker-dealer wishes to commence operations also review the application and applicants' disclosures.

Normally, the broker-dealer can begin operations only after registering with the Commission, SRO and applicable state(s).<sup>2</sup> Subsequently, broker-dealers update Form BD through amendments filed with the Commission, SRO and applicable states.

In calendar year 2000, approximately 7,500 broker-dealers were already registered with the Commission, and 837 new broker-dealers registered. Between January and August 2001, more than 300 broker-dealers registered.

<sup>1</sup> The SRO may extend the 180 day timeframe.

<sup>2</sup> Broker-dealers whose business is solely intrastate are not required to register with the Commission. Some states do not require state registration.

MR and OFIS also process broker-dealer cancellations and withdrawals. The Commission initiates a cancellation, while a broker-dealer initiates a withdrawal.

The Commission may cancel a broker-dealer's registration if it finds that the firm is no longer in existence or has ceased doing business as a broker-dealer. The Commission cancelled approximately 400 registrations in 2000 and nearly 300 between January and July 2001. Cancellation is normally done once a quarter.

If a broker-dealer stops doing business and wishes to withdraw its registration from the Commission, it must file a broker dealer withdrawal form (Form BDW) with the Commission, SRO(s) and state(s) where it is a member. This form requires the broker-dealer to disclose the amount of any funds or securities it owes customers, and whether it is the subject of any proceeding, unsatisfied judgments, liens, or customer claims.

The withdrawal form and other relevant information (*e.g.*, a pending enforcement investigation) are used to determine whether the public interest permits withdrawal. Withdrawal applications are typically processed 60 days after receiving a completed application.<sup>3</sup> The Commission processed 633 withdrawals in calendar year 2000, and 365 between January and July 2001.

The Commission may also revoke a broker-dealer's registration when an administrative proceeding so orders. Typically, the broker-dealer has violated securities laws and regulations, and the public interest requires revocation.

When a revocation is processed, MR and OFIS staff update relevant data systems. The Secretary's Office issues a Commission order to inform interested parties. Since 1997, administrative proceedings have resulted in 30 broker-dealer revocations.

## AUDIT RESULTS

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### COMMUNICATION

MR and OFIS personnel have a good working relationship and communicate effectively with each other.

Commission officials work closely with SRO staff in all aspects of the broker-dealer registration process. Commission officials also participate in conferences with SRO and state securities regulators to discuss related policy issues, the registration process, and to share information.

Generally, SRO officials commended Commission staff on their responsiveness and willingness to assist the SROs. Officials from the SROs and state securities regulators commented on several policy areas such as making changes to the broker-

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<sup>3</sup> When a broker-dealer withdraws its registration, the Commission's jurisdiction over the broker-dealer is limited. The 60 day time period enables Commission staff to determine if there are valid reasons to delay a withdrawal.

dealer registration form, interpretive guidance, broker-dealer net capital requirements, and requirements for persons wanting to become broker-dealers.<sup>4</sup> We found that Commission officials were aware of these issues.

## **TIMELINESS OF REGISTRATIONS AND CANCELLATIONS**

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We determined the number of days it took the Commission to register a sample of 75 broker-dealers from 1999 through 2001 (a sample of 25 from each year), using a report generated by the Office of Information Technology (OIT). In only one instance did registration take more than the required 45 days (66 days). The average was only 18 days.

Our test indicated that the Commission is generally registering broker-dealers in significantly less time than the regulatory target. Similarly, our review of cancellations indicated that they are being processed timely.

## **TIMELINESS AND ACCURACY OF WITHDRAWALS**

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We reviewed a printout of all broker dealers whose registration was withdrawn between January 1, 1999 and July 2001. Although the majority of withdrawals were completed timely (on the 60<sup>th</sup> day), we noted the following exceptions:

- Staff miscalculated the 60 day period in several instances, resulting in several withdrawals being processed in just under or over the 60 day timeframe.
- The time periods for processing some withdrawals could not be determined because of data entry errors. For example, the date of the withdrawal request was recorded as later than the date the withdrawal was approved in some instances.

We discussed these issues with OFIS staff. They researched instances where the timeframe was not sixty days and updated their computer systems to correct data entry and other errors.

### ***Recommendation A***

OFIS should ensure that withdrawals are processed timely, and the 60 day time frame is calculated accurately.

During the audit, an OFIS official met with appropriate staff to reiterate the importance of timeliness and accuracy in completing the withdrawal process. OFIS officials also said they would review a monthly printout showing the number of days to process withdrawals.

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<sup>4</sup> The Inspector General's Office did not evaluate any policy issues as part of the audit.

## UPDATES AFTER REVOCATIONS

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After a revocation order is issued as a result of an administrative proceeding, OFIS has to update official records (CRD, Workload, and the Regulation Entity database). We found that the updates are not always timely.

In twenty-five of the thirty revocations processed since 1997, the update took fifteen days or more, and in one case took 770 days. More recently (since January 1, 2000), of eight revocations processed, five took fifteen days or more, with one taking 130 days.<sup>5</sup>

Timely updating is important so that the Commission can provide the public with accurate information about a broker-dealer's status. Many investors call the Commission or use its public databases to learn whether a broker-dealer is registered. Accurate information is especially important in these cases, where a broker-dealer's license has been revoked due to security law violations.

OFIS staff currently review a listing of administrative proceedings on the Commission's intranet site (The Insider) to learn of revocations. However, due to oversights, OFIS staff did not always timely identify these administrative proceedings. We also noted the following:

- One administrative proceeding was not posted on The Insider but should have been.
- Certain types of administrative proceedings (default orders) are not currently posted on The Insider (2 instances).
- Certain types of administrative proceedings (Commission opinions) are posted on The Insider, but not under the Administrative Proceedings tab, where OFIS looks (1 instance). They are posted under "Commission Opinions."

The Office of the Secretary normally posts administrative proceedings (not including default orders) on The Insider within two days of the final order. Overviews of administrative proceedings (not including default orders) are recorded in the "Digest," which is posted daily on The Insider. All administrative proceedings, however, are posted in hard copy in the docket, which is released weekly.

### ***Recommendation B***

The Office of the Secretary should post all administrative proceedings, including default orders, on The Insider.

### ***Recommendation C***

OFIS should review listings of administrative proceedings on a regular basis and implement procedures to minimize oversights and ensure that systems are updated in a timely manner to reflect revocations.

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<sup>5</sup> Time frames for updates are not set by regulation; we chose fifteen days as a reasonable period.

## DATA RELIABILITY AND CONSISTENCY

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We noted the following data errors, which were corrected during the audit:

- The date on which the Commission received more than 4,000 broker-dealer applications was recorded differently in Workload and the Regulated Entity Database.
- One or more of the Commission's systems incorrectly classified some broker-dealers. For example, broker-dealers were erroneously classified as active, canceled, or withdrawn.

We also noted small differences between application receipt dates in CRD and Workload. MR, OFIS and OIT staff began researching the reasons for the errors during the audit.

### *Recommendation D*

MR and OFIS should coordinate with OIT to identify the reasons for data errors, and take actions to ensure that the data in different systems are consistent and accurate.

## POLICIES AND PROCEDURES

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OFIS is currently drafting policies and procedures for its role in the broker-dealer registration process. MR does not currently have written policies and procedures.

This written guidance would be helpful to its staff.

### *Recommendation E*

OFIS should finalize its broker-dealer policies and procedures.

### *Recommendation F*

MR should prepare policies and procedures for broker-dealer registration and set a deadline for completion.

The guidance should include the timeliness and accuracy issues discussed in this report. The guidance should also clearly define each organization's role in the broker-dealer registration process.