



RISK ALERT

DIVISION OF EXAMINATIONS

June 5, 2024

Broker-Dealers: Staff Assessment of Risks, Scoping of Examinations, and Requesting of Documents*

I. Introduction

SEC-registered broker-dealers (“broker-dealers” or “firms”) engage in a variety of market activities, including retail-focused and institutional-focused sales, assisting issuers in capital raising and offerings, producing research on securities, and making markets in a range of asset classes.¹ Some broker-dealers focus on a single or small number of business lines or products while others provide a wide-range of products and services. Given the variety in the broker-dealer population, the Division utilizes a risk-based approach for both selecting firms to examine and in determining the scope of risk areas to review in each examination.

The SEC’s mission is to protect investors; maintain fair, orderly and efficient markets; and facilitate capital formation. Assessing broker-dealers’ compliance with the federal securities laws and the rules thereunder is crucial to fulfilling this mission. The Division conducts examinations to, among other things: (1) improve compliance; (2) prevent fraud; (3) monitor risk; and (4) inform policy. For example, the Division examines firms’ compliance with investor protection requirements such as Regulation Best Interest,² market quality rules such as Reg SHO,³ and requirements for securities offerings under Section 5 of the Securities Act of 1933, including consistency with the requirements of an exemption under the Securities Act of 1933.⁴

On a continual basis, the Division aims to direct resources to address emerging risks, new and developing industry practices and products, and regulatory developments. The Division leverages technology to collect and analyze large sets of industry- and firm-level data to help identify risks when determining which firms to examine and when conducting individual

* The views expressed herein are those of the staff of the Division of Examinations (“Division” or “EXAMS”). This Risk Alert is not a rule, regulation, or statement of the Securities and Exchange Commission (“SEC” or “Commission”). The Commission has neither approved nor disapproved the content of this Risk Alert. This Risk Alert, like all staff statements, has no legal force or effect; it does not alter or amend applicable law, and it creates no new or additional obligations for any person.

¹ As of March 18, 2024, approximately 3,400 broker-dealers are registered with the SEC, which represents over 6250,000 registered personnel and over 125,000 registered offices. These broker-dealers hold over \$5.5 trillion in assets.

² 17 CFR 240.15f-1.

³ 17 CFR 242.200.

⁴ 17 CFR 230.500.

examinations. The Division also reviews disclosure documents and various filings with regulators (e.g., Form BD and FOCUS reports).⁵

This Risk Alert provides additional information regarding the Division's examination selection process and includes an Appendix describing the types of documents and information that Division staff may request during an examination.

II. Assessing Risks and Scoping Examinations

A. Selecting Firms to Examine

When selecting broker-dealers as potential examination candidates, Division staff may consider, among other things: (1) prior examination history;⁶ (2) supervisory concerns, such as disciplinary history of associated individuals or affiliates; (3) tips, complaints, or referrals involving the firm; (4) the length of time since the firm's last examination; (5) the firm's customer base; (6) products and services the firm offers; (7) financial notifications or alerts that indicate that the broker-dealer is experiencing financial stress; (8) reporting by news and media that may involve or impact the firm; (9) information filed by the firm with the SEC or with a self-regulatory organization; and (10) whether the firm holds customer cash and securities.

The Division also may select for examination a specific office or branch of a broker-dealer based on the risk factors identified with that location (e.g., customer complaints or outside business activities of personnel working from that location). Each year, the Division's publication of its annual priorities provides broker-dealers with insight regarding those areas that the Division has identified as the key risks, trends, and examination areas that the Division plans to focus on in the upcoming year, including certain products, services, business operations, or practices.⁷

B. Selecting Examination Focus Areas

The scope of an examination, and consequently the documents requested, will vary from examination to examination depending on the examined firm's business model, associated risks, and the Division's reason for conducting the examination. The staff may also consider whether the firm has been subject to an examination in a similar area by a self-regulatory organization.⁸

⁵ [Form BD](#); [FOCUS report](#).

⁶ Broker-dealers are subject to examination by any self-regulatory organization of which the broker-dealer is a member. Most broker-dealers are members of, and are examined by, FINRA. The staff will evaluate the results of examinations by the Division and by the self-regulatory organization.

⁷ See, e.g., Division, [FY 2024 Examination Priorities](#) (Oct. 16, 2023).

⁸ As part of the pre-examination planning process, the staff actively coordinates examination oversight to ensure that regulatory efforts are not duplicative. However, an earlier examination by a self-regulatory organization will not necessarily preclude an SEC examination in the same area.

The examination scope may be adjusted during the examination based on information received and staff observations.⁹

III. Selecting Documents to Request – Potential Information That May Be Requested

As part of the examination process, the staff usually sends a letter notifying the firm of the upcoming examination, which contains an initial request list identifying certain information, including documents that the staff will review as part of the examination. The initial request for information may include: (1) general information, which provides the staff with an understanding of the broker-dealer's business and securities activities; (2) the written policies and procedures the firm has established, maintained, and enforced to address the firm's securities activities; and (3) information for the staff to perform its own testing for compliance in various areas.

To assist broker-dealers further, the Division is providing the Sample Initial Information Examiners Request of Broker-Dealers as an Appendix to this Risk Alert.

IV. Conclusion

The Division is providing this information so that broker-dealers may prepare themselves for an examination. Although the Division continually refines and enhances its risk assessment process, the information shared herein also may assist firms in their compliance efforts.

This Risk Alert is intended to highlight for firms risks and issues that Division staff has identified. In addition, this Risk Alert describes risks that firms may consider to (1) assess their supervisory, compliance, and/or other risk management systems related to these risks, and (2) make any changes, as may be appropriate, to address or strengthen such systems. Other risks besides those described in this Risk Alert may be appropriate to consider, and some issues discussed in this Risk Alert may not be relevant to a particular firm's business. The adequacy of supervisory, compliance and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.

⁹ Ultimately, the scope of an examination will determine whether a given item is included within an initial document request. See also Division, [Information for Entities Subject to Examination or Inspection by the Securities & Exchange Commission \(Examination Brochure\)](#) (last updated March 2023) for additional information regarding the examination process.

Attachment: Sample Initial Information Request List

Described below are the types of information, including documents, that staff may initially request and review during an examination of a broker-dealer. These information requests are generally transmitted through secure email, and responses are also typically provided electronically. If certain records are not maintained electronically or cannot be produced electronically, the staff may request that the broker-dealer make such records available for in-person examination. Staff will identify a time period (“review period”) and request all documents that were in effect or generated during such period. Firms should be aware that the “review period” will differ for each examination.

General Information	
Organizational Information	<ul style="list-style-type: none"> • Organizational structure, affiliations, and control persons. • Remote offices and branch locations. • Firm employees. • Committees (<i>e.g.</i>, responsibilities, members, meeting frequency, meeting minutes).
Business and Operations	<ul style="list-style-type: none"> • Description of the firm’s business, including any recent significant changes. • Clearing agreements. • Website domain addresses used by the firm and by associated persons. • Compensation arrangements for associated persons, including bonus and non-cash compensation.
Financial Information	<ul style="list-style-type: none"> • Annual audited report(s). • Income statement(s). • General ledger(s). • Profit and loss statement(s). • Expense and revenue sharing agreements.
Legal and Disciplinary	<ul style="list-style-type: none"> • Pending and settled litigation, arbitration, or Administrative Proceeding involving the firm or any supervised person. • Inquiries, complaints, investigations, or subpoenas from any regulatory authority received by the firm. • List of all associated persons who have been subject to special or heightened supervision or terminated for cause.
Supervisory and Compliance Structure	

Books and Records, and Compliance and Oversight Processes	<ul style="list-style-type: none"> • Written supervisory and compliance policies and procedures. • Oversight Processes (e.g., compliance reviews, surveillance, and/or supervisory reviews). • Customer complaints and correspondence and the process for monitoring such communications, including electronic communication. • Written guidance and training provided to employees and any documentation of attendance.
Branch Office Oversight	<ul style="list-style-type: none"> • List of branch offices, including “doing business as” names. • Description of the firm’s process to perform branch office inspections. • Any Profit and Loss statement by branch. • List of registered personnel within selected branches and their compensation earned. • List of associated persons’ outside business activities.
Information Processing, Reporting, and Protection	<ul style="list-style-type: none"> • Safeguards for the protection of customer records and information. • Electronic access controls. • Business continuity plan. • Cybersecurity incidents or breaches (e.g., incident description, impact, and remediation).
Regulatory Requirements (Select Topics)	
Sales Practices, Regulation Best Interest, and Form CRS	<ul style="list-style-type: none"> • List of products sold. • Customer fee schedule. • Written policies and procedures for Regulation Best Interest and Form CRS compliance. • Customer account list. • Purchase and Sales Blotter. • List of offerings or private placements facilitated or sold by the firm. • Form CRS and Regulation Best Interest Disclosures. • Surveillance and Monitoring Reports. • Any Conflicts inventory.
Anti-Money Laundering (“AML”)	<ul style="list-style-type: none"> • List of current or ongoing external investigations and/or inquiries by regulatory entities into any AML related functions. • List of any committees that regularly discuss topics/issues relating to compliance with AML requirements. • AML written supervisory policies and procedures. • List of customer accounts with risk rankings and date of onboard and most recent know-your-customer review. • Surveillance, monitoring, and management reports. • Most recent reviews performed over the firm’s know-your-customer, transaction

	<p>monitoring, and suspicious activity report handling areas.</p>
<p>Net Capital and Customer Protection</p>	<ul style="list-style-type: none"> • FOCUS reports. • Trial balance and balance sheets. • Net capital computation, including all supporting workpapers. • List of all bank accounts and customer checks. • Payables and receivables. • Changes in ownership equity. • Cash disbursement journal. • 15c3-3 Customer and PAB¹⁰ reserve computations and workpapers. • Reserve bank account statements and no-lien letters. • Allocations for customer and PAB reserve computation. • Concentration reports used for customer margin debit balances.

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The term *PAB account* means a proprietary securities account of a broker or dealer (which includes a foreign broker or dealer, or a foreign bank acting as a broker or dealer) other than a delivery-versus-payment account or a receipt-versus-payment account. The term does not include an account that has been subordinated to the claims of creditors of the carrying broker or dealer. 17 CFR 240.15c3-3(a)(16).