

SEC Risk Alert

Broker-Dealer Examinations: Risk Assessment, Scoping, and Document Requests

On June 5, 2024, the Securities and Exchange Commission (**SEC**) Examination Division published a risk alert providing insight into how it selects, scopes, and conducts examinations of registered broker-dealers. Although *Core* clients typically are registered as investment advisers, not broker-dealers, some of the practices and focus areas noted in the risk alert may nevertheless be insightful. The Exam Division reiterated that it conducts examinations to, among other things: (1) improve compliance; (2) prevent fraud; (3) monitor risk; and (4) inform policy. The risk alert provided examples of examining compliance with investor protection requirements such as Regulation Best Interest and market quality rules such as the short selling provisions of Reg SHO. The risk alert further noted that the Exam Division seeks to direct resources to address emerging risks, industry, and regulatory developments, and to leverage technology to collect and analyze large data sets to identify risks when selecting and conducting examinations. The risk alert provided additional information regarding its process for assessing risks, scoping examinations, and requesting documents as follows.

Selecting Firms to Examine

The risk alert noted that SEC exam staff may consider the following factors when selecting broker-dealers and/or specific branch offices for examination and also directed readers to the Division's annual Exam Priorities memo for additional insights regarding key risks, trends, and focus areas for examinations. A couple of these factors (as noted in green) are applicable solely to broker-dealers or based on information reported in Form BD or broker-dealer FOCUS reports filed with the SEC, but most also relate to investment advisers and private funds.

- Prior examination history;
- Supervisory concerns or disciplinary history of associated individuals and affiliates;
- Tips, complaints, or referrals involving the firm;
- The length of time since the firm's last examination;
- The firm's customer base;
- Products and services the firm offers;
- **Financial notifications or alerts that indicate the firm is experiencing financial stress;**
- Reporting by news and media that may involve or impact the firm;
- Information filed by the firm with the SEC **or a self-regulatory organization (SRO);** and
- Whether the firm holds customer cash and securities.

Selecting Examination Focus Areas

The risk alert noted that the scope of the examination will vary depending on the firm's business model, associated risks, and reasons for conducting the examination. Broker-dealers are also subject to examination by SROs, including the Financial Industry Regulatory Authority (**FINRA**) and market exchanges of which they are members (e.g., the New York Stock Exchange). The SEC has oversight authority for such SRO examination programs, and as noted in the risk alert, SEC staff actively coordinate with FINRA and other SROs to ensure that regulatory efforts are not duplicative. Accordingly, the risk alert noted that the SEC may consider whether a firm has been subject to an examination in a similar area by an SRO, but that an earlier examination will not necessarily preclude an SEC examination in the same area.

Selecting Document Requests

The risk alert confirmed that SEC staff usually send through a security email a document request list as part of their examination announcement letter. Requested documents are also provided electronically and typically include:

- General information regarding the broker-dealer's business and securities activities;
- The firm's written policies and procedures to address the firm's securities activities; and
- Information needed for the staff to perform testing for compliance in various areas.

The risk alert included a sample document broker-dealer request list, which can be accessed through the link below. Many of the items are specific to broker-dealers, based on applicable books and records requirements. General information requests included: a) organizational information; b) business and operations; c) financial information; and d) legal and disciplinary. Supervisory and compliance requests included: e) books and records, and compliance and oversight processes; f) branch office oversight; and g) information processing, reporting, and protection. Finally select regulatory topic requests included: h) sales practices, Regulation Best Interest, and Form CRS; i) anti-money laundering (AML); and j) net capital and customer protection.

See Risk Alert - <https://www.sec.gov/files/risk-alert-broker-dealer-exam-planning.pdf>