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**California Department of
Financial Protection and Innovation**

Broker-Dealer / Investment Adviser Program 2023 Annual Report to the Legislature

PROTECTING CONSUMERS
FOSTERING TRUST & INNOVATION

DFPI 
DEPARTMENT OF FINANCIAL
PROTECTION & INNOVATION



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PROTECTION & INNOVATION

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Department of Financial Protection and Innovation

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January 10, 2023

Dear Senators and Assemblymembers:

The Department of Financial Protection and Innovation (DFPI) respectfully submits the attached 2023 Report on the Broker-Dealer and 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 2021-2022 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. The report also can be found on the DFPI website at www.dfpi.ca.gov.

Sincerely,

Clothilde V. Hewlett
Commissioner
Department of Financial Protection and Innovation

Broker-Dealer and Investment Adviser Program 2023 Report to the Legislature

The Broker Dealer and Investment Adviser (BDIA) Program licenses and regulates investment advisers, investment adviser representatives, broker-dealers, and broker-dealer agents. The work in this program is done pursuant to the Corporate Securities Law of 1968. 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	2019-20	2020-21	2021-22
Investment Adviser Firms	3,743	3,734	3,675
Investment Adviser Representatives	56,685	57,738	58,187
Broker-Dealer Firms	2,618	2,578	2,570
Broker-Dealer Agents	296,366	300,492	309,899
Broker-Dealer Branch Offices	16,740	16,395	15,977

1. Number of positions authorized and filled

The BDIA Program has a total of 90 authorized positions, including one position allocated by the Legislature in the 2022-23 fiscal year. Currently 88 of the 90 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 since FY 2019-20.

Licensee Type	Number of Licensees			Number of Exams Completed			Percent of Licensees Examined		
	2019-20	2020-21	2021-22	2019-20	2020-21	2021-22	2019-20	2020-21	2021-22
Investment Adviser Firms	3,743	3,734	3,675	693*	500**	471***	18.51%	13.39%	12.81%
Broker-Dealer (In-State)	407	394	377	16	17	18	3.93%	4.31%	4.77%
Broker-Dealer (Out-of-State)	2,211	2,184	2,214	0	0	0	0%	0%	0%
Broker-Dealer Branch Offices	16,740	16,395	15,977	32	29	29	0.19%	0.17%	0.18%
Total	23,101	22,707	22,243	741	546	518	22.63%	17.89%	17.76%

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

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

***The total Investment Adviser examinations numbers includes 195 examinations conducted by examination questionnaire.

3. Results and outcomes of examinations

The BDIA Program completed 518 examinations of broker-dealers, broker-dealer branch offices, and investment advisers in FY 2021-22. Of the total examinations, 195 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. 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.

The following table shows the number of online examinations conducted for Investment Adviser licensees.

Online Investment Adviser Examinations	
Fiscal Year	Number of Exams Completed
2018-19	598*
2019-20	176
2020-21	183
2021-22	195

*This fiscal year was unique in that all out of state CA registered Investment Advisers were selected for examination.

Of the 518 total examinations completed, violations were found in 14 of the examinations, which resulted in referrals to the DFPI's Enforcement Division for administrative actions and/or penalties. The remaining examinations identified books and records violations for which the licensees took corrective action by implementing procedures to mitigate future violations. The following table shows the number of examinations resulting in direct Enforcement referrals.

Examinations Referred to Enforcement	
Fiscal Year	Number of Exams Referred
2019-20	19
2020-21	17
2021-22	14

In addition to direct examination referrals to the Enforcement Division, in FY 2021-22 the BDIA Program, in collaboration with the Enforcement Division, began issuing program-issued consent orders for administrative actions for licensing and examination matters.

The consent orders for licensing included matters related to renewals of firm registration and failures to file annual updates. Program-issued consent orders were executed for examination issues related to licensee's failure to comply with California rules and regulations. Consent orders included orders to discontinue violations.

The following table shows the number of consent orders issued by the program.

Program Issued Consent Orders			
Fiscal Year	Number of Program Issued Consent Orders		
	Licensing	Exams	Total
2021-22	18	4	22

As a result of the COVID-19 pandemic, the DFPI staff began to telework in March 2020, and most staff continue to work in a hybrid arrangement. The BDIA Program 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.

While the program staff remain amenable and responsive to the concerns and needs of its licensees and staff, the BDIA Program has implemented a hybrid approach to examinations and an overall increase in the use of electronic communication. Hybrid examinations, involving both remote and on-site components, allow program staff to be more efficient and effective. Program staff conduct in-person interviews of the licensee's owners and compliance personnel and are on-site for the collection and review of examination documentation. As the program continues to evaluate its business operations, it will remain flexible with licensees and committed to its broader mission to protect consumers through the dedicated examination process.

Effective January 1, 2020, SB 496 (Chapter 272, Statutes of 2019) 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 mandated reporters, 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 January 1, 2020, when the law became operative, to June 30, 2022, the Department has received and reviewed 1,511 reports.

	SB 496 Reports
FY 2019-20*	123
FY 2020-21	576
FY 2021-22	812
Total reports	1,511

*Began receiving reports on 1/1/2020 when law became operative

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 states 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 3,675 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 2,570 broker-dealer firms are registered with the DFPI. Of these, 377 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 377 firms.

The SEC, FINRA, and other 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 15,977. 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 one to three 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 medium or high risk is used to calculate the required number of examiners. This is illustrated in the table below.

Number of Broker-Dealer Branch Locations	Number of Associated Individuals with Disclosures* at the identified branch office locations in column 1	Identified Risk Levels
655	3 or more individuals	Medium risk
660	2 individuals	Low risk (a)
3,556	1 individual	Low risk (b)
11,106	0 individuals with disclosures	Low risk (c)
Total: 15,977		

*Individuals with disclosures: associated persons of the firm that have violated any securities, insurance, commodities, financial or investment-related laws, rules, regulations, or standards of conduct of any domestic or foreign regulatory body or self-regulatory organization. Disclosure events include, but are not limited to customer complaints, regulatory actions, criminal actions and statutory disqualifications.

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
Investment Advisers	3,675	4	918	80	73,440	1,660	44
Broker-Dealer Firms (In-state)	377	4	94	100	9,400	1,660	6
Broker-Dealer Branch Offices (medium risk)	655	4	163	80	13,040	1,660	8
Totals	4,707		1,175		95,880	1,660	58

* 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 90 authorized positions for FY 2022-23. Of these positions, 68 are allocated to examinations [56 examiners perform regulatory examinations and prepare audit workpapers, and 12 positions are supervisory which perform reviews of audit workpapers, issue examination reports, manage the corrections of examination findings/violations and review Enforcement related matters]; two positions review investor complaints and elder abuse reports; nine positions perform licensing reviews and management approval functions; and 11 positions, including the Deputy Commissioner (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.

HISTORICAL REPORTING	2023 Report	2022 Report	2021 Report	2020 Report	2019 Report	2018 Report	2017 Report
Total Staff Authorized	90	89	89	89	90	82	73
Examination ^a	58	57	57	57	61	53	47
Licensing	8	8	8	8	8	8	7
Management and support (includes exam managers)	24	24	24	24	21	21	19
Number of Examination Staff Needed	58	60	62	63	63	65	303
Available Examination Staff	56	56	57	57	61	53	47
Additional Examiners Needed	2	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.

UPDATED REPORTING	2023 Report	2022 Report	2021 Report	2020 Report	2019 Report	2018 Report	2017 Report
Total Staff Authorized	90	89	89	89 ^b	90	82	73
Examination (includes exam managers)	68	68	68	68	69	61	53
Licensing	9	9	8	8	8	8	7
Complaint and elder abuse review	2	1	1	1	1	1	1
Leadership and support staff ^c	11	11	12	12	12	12	12
Number of Examiners Needed to perform examinations	58	60	62	63	63	65 ^d	256
Available Authorized Examiners	56	56	56	56	56	56	56
Additional Examiners Needed	2	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. The new allocated position for elder abuse reports is also being 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 two additional examiners to meet the statutory target four-year examination cycle for investment adviser firms, broker-dealer firms (in-state) and high-risk broker-dealer branch offices.

Estimated Required Staffing:	
Number of Examination Staff Needed	58
Available Examination Staff	56
Additional Examiners Needed	2

If additional examiners are not authorized, the program is 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. While additional staff will be required to meet the current length of examination cycles, the BDIA program has also identified options for increasing efficiencies in its supervision of BDIA licensees. These 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 DFPI will continue to participate in quarterly discussions with FINRA on exam strategies and data regarding broker-dealers and broker-dealer branches. The DFPI will report its findings relative to any new considerations and examination results in next year's annual report.



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