

2024

**California Department of
Financial Protection and Innovation**

**Broker-Dealer / Investment Adviser Program
2024 Annual Report to the Legislature**

PROTECTING CONSUMERS
FOSTERING TRUST & INNOVATION

DFPI 
DEPARTMENT OF FINANCIAL
PROTECTION & INNOVATION



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Dear Senators and Assembly Members:

The Department of Financial Protection and Innovation (DFPI) respectfully submits the attached 2024 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. Broker-dealers and investment advisers play an important role in providing access to our capital markets, thereby providing avenues to building generational wealth. As the securities regulator for California, we are focused on investor protection and improving responsible investment opportunities for Californians.

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 2022-2023 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 or Acting Deputy Commissioner of BDIA, Michael Nelson with questions or concerns. Nicole can be reached by phone at (916) 539-0181 or by email at Nicole.Hisatomi@dfpi.ca.gov. Michael can be reached by phone at (415) 471-9321 or by email at Michael.Nelson@dfpi.ca.gov. The report also can be found on the DFPI website at dfpi.ca.gov.

Sincerely,

Clothilde V. Hewlett
Commissioner
Department of Financial Protection and Innovation

Broker-Dealer and Investment Adviser Program 2024 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	2020-21	2021-22	2022-23
Investment Adviser Firms	3,734	3,675	3,697
Investment Adviser Representatives	57,738	58,187	58,893
Broker-Dealer Firms	2,578	2,570	2,572
Broker-Dealer Agents	300,492	309,899	321,304
Broker-Dealer Branch Offices	16,395	15,977	15,599

1. Number of positions authorized and filled

The BDIA Program has a total of 90 authorized positions. Currently 85 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 2020-21.

Licensee Type	Number of Licensees			Number of Exams Completed			Percent of Licensees Examined		
	2020-21	2021-22	2022-23	2020-21	2021-22	2022-23	2020-21	2021-22	2022-23
Investment Adviser Firms	3,734	3,675	3,697	500*	471**	563***	13.39%	12.81%	15.22%
Broker-Dealer (In-State)	394	377	360	17	18	23	4.31%	4.77%	6.38%
Broker-Dealer (Out-of-State)	2,184	2,214	2,212	0	0	0	0%	0%	0%
Broker-Dealer Branch Offices	16,395	15,977	15,599	29	29	32	0.17%	0.18%	0.20%
Total	22,707	22,243	21,868	546	518	618	2.40%	2.32%	2.82%

*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.

*** The total Investment Adviser examinations numbers includes 206 examinations conducted by examination questionnaire.

3. Results and outcomes of examinations

The BDIA Program completed 563 examinations of broker-dealers, broker-dealer branch offices, and investment advisers in FY 2022-23. Of the total examinations, 206 were conducted 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, which meant that 25 percent of the licensee population would be examined annually.

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
2022-23	206

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

Of the 563 total examinations completed, violations were found in seven 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
2022-23	7

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 orders for administrative actions for certain licensing and examination matters.

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

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

Program Issued Orders			
Fiscal Year	Number of Program Issued Orders		
	Licensing	Exams	Total
2021-22	18	4	22
2022-23	40	3	43

Many DFPI staff are remote centered, and most staff continue to work in a hybrid arrangement. The BDIA Program has adopted new procedures to keep up with examination efforts. Staff use video conferencing tools to enhance engagement with licensees during entrance and exit interviews.

The BDIA Program continues its use of electronic communications through a hybrid approach to examinations. These hybrid examinations involve both remote and on-site components, allowing the DFPI to tailor the examination to the Department’s priorities and needs while maintaining efficiency and effectiveness. As the program continues to evaluate and improve its operations, it is committed to remaining flexible with licensees, while protecting 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 broker-dealers and investment adviser licensees 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, 2023, the Department has received and reviewed 2,580 reports.

	SB 496 Reports
FY 2019-20*	123
FY 2020-21	576
FY 2021-22	812
FY 2022-23	1069
Total reports	2,580

*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 for 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 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 3,697 investment adviser firms are registered with the DFPI. 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 2,572 broker-dealer firms are registered with the DFPI. Of these, 360 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 360 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 outlined below.

Broker-Dealer Branch Offices

The total number of broker-dealer branch offices reported in California is 15,599. 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
614	3 or more individuals	Medium risk
585	2 individuals	Low risk (a)
3,334	1 individual	Low risk (b)
11,066	0 individuals with disclosures	Low risk (c)
Total: 15,599		

*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	3,697	4	924	80	73,920	1,660	45
Broker-Dealer Firms (In-State)	360	4	90	100	9,000	1,660	5
Broker-Dealer Branch Offices (Medium Risk)	614	4	154	80	12,320	1,660	8
Crypto asset-related Complex Exams	n/a	n/a	40	n/a	n/a	1,660	2
Totals	4,671		1,208		95,240	1,660	60

* Number of licensees fluctuates annually, 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, including the Deputy Commissioner (CEA). Of these positions, 68 are allocated to examinations. Fifty-six 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 10 positions provide support to the program.

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

In addition, the four SFIEs will take the lead on complex examinations by researching new technology applications relating to digital assets and automated trading activities and update examination procedures focused on crypto asset-related activities. The SFIEs will be responsible for leading, training, and coordinating the work of the examiners in the program.

Estimated Required Staffing:	
Number of Examination Staff Needed	60
Available Examination Staff	56
Additional Examiners Needed	4

While additional staff may 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.



California Department of Financial Protection and Innovation

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