

OFFICE OF
**INSPECTOR
GENERAL**

OFFICE OF AUDITS

**Enhanced Planning, Performance
Measurement and Evaluation, and
Information Can Improve Oversight
of Broker-Dealer Examinations**

This report contains non-public information about the U.S. Securities and Exchange Commission's examination program. We redacted the non-public information to create this public version.

REDACTED FOR PUBLIC RELEASE



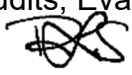
OFFICE OF
INSPECTOR GENERAL

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

M E M O R A N D U M

September 23, 2024

TO: Keith Cassidy, Acting Director, Division of Examinations

FROM: Rebecca L. Sharek, Deputy Inspector General for Audits, Evaluations,
and Special Projects, Office of Inspector General 

SUBJECT: *Enhanced Planning, Performance Measurement and Evaluation, and Information
Can Improve Oversight of Broker-Dealer Examinations, Report No. 583*

Attached is the Office of Inspector General (OIG) final report detailing the results of our evaluation of the U.S. Securities and Exchange Commission's (SEC) Division of Examinations' (EXAMS) oversight of broker-dealer examinations. The report contains six recommendations that should further strengthen EXAMS' oversight of its broker-dealer examinations and ensure those examinations fully support the SEC's mission.

On August 22, 2024, we provided management with a draft of our report for review and comment. In its September 13, 2024, response, management concurred with our recommendations. We have included management's response as Appendix II in the final report.

Within the next 45 days, please provide the OIG with a written corrective action plan that addresses the recommendations. The corrective action plan should include information such as the responsible official/point of contact, timeframe for completing required actions, and milestones identifying how management will address the recommendations.

We appreciate the courtesies and cooperation extended to us during the evaluation. If you have questions, please contact me or Colin Heffernan, Audit Manager.

Attachment

cc: Gary Gensler, Chair
Amanda Fischer, Chief of Staff, Office of Chair Gensler
Corey Klemmer, Policy Director, Office of Chair Gensler
Kevin Burris, Counselor to the Chair and Director of Legislative and
Intergovernmental Affairs
Scott Schneider, Counselor to the Chair and Director of Public Affairs
Philipp Havenstein, Operations Counsel, Office of Chair Gensler
Ajay Sutaria, Legal Counsel, Office of Chair Gensler
Hester M. Peirce, Commissioner
Benjamin Vetter, Counsel, Office of Commissioner Peirce

Caroline A. Crenshaw, Commissioner
Malgorzata Spangenberg, Counsel, Office of Commissioner Crenshaw
Mark T. Uyeda, Commissioner
Holly Hunter-Ceci, Counsel, Office of Commissioner Uyeda
Jaime Lizárraga, Commissioner
Laura D'Allaird, Counsel, Office of Commissioner Lizárraga
Parisa Haghshenas, Counsel, Office of Commissioner Lizárraga
Megan Barbero, General Counsel
Elizabeth McFadden, Deputy General Counsel General Litigation, Office of the
General Counsel
Lisa Helvin, Principal Deputy General Counsel for Adjudication and Oversight, Office
of the General Counsel
David Leviss, Associate General Counsel for Oversight and Investigations, Office
of the General Counsel
Stephen Jung, Assistant General Counsel for Intragovernmental and
Congressional Affairs, Office of the General Counsel
Kenneth Johnson, Chief Operating Officer
Shelly Luisi, Chief Risk Officer
Jim Lloyd, Assistant Chief Risk Officer/Audit Coordinator, Office of the Chief Risk
Officer
Michael Rufino, Associate Director/National Head of BDX, Division of Examinations
Jennifer McCarthy, Chief Counsel, Office of Chief Counsel, Division of Examinations
Michael Hershaf, Senior Special Counsel, Office of Chief Counsel, Division of
Examinations
Deborah J. Jeffrey, Inspector General



EXECUTIVE SUMMARY

Enhanced Planning, Performance Measurement and Evaluation, and Information Can Improve Oversight of Broker-Dealer Examinations

REPORT NO. 583 | SEPTEMBER 23, 2024

WHY WE DID THIS EVALUATION

The U.S. Securities and Exchange Commission (SEC or agency) conducts examinations of market participants, including broker-dealers, to protect investors, ensure market integrity, and support responsible capital formation. Between fiscal years 2020 and 2023, the SEC's Division of Examinations (Division or EXAMS) completed 1,352 broker-dealer examinations, with over 90 percent conducted by the Division's Broker-Dealer and Exchange examination program (BDX). Using risk-based strategies, examinations improve compliance, prevent fraud, monitor risk, and inform policy.

We conducted this evaluation to assess whether EXAMS was effectively overseeing its broker-dealer examinations. Specifically, we sought to determine whether EXAMS (1) effectively used risk-based strategies in the selection and scoping of broker-dealer examinations; (2) performed and documented broker-dealer examinations in accordance with applicable policies and procedures; and (3) monitored and assessed results of examinations to enhance oversight of broker-dealer compliance and accurately measure EXAMS' performance.

WHAT WE RECOMMENDED

We made six recommendations to further strengthen EXAMS' oversight of its broker-dealer examinations and ensure those examinations fully support the SEC's mission. Management concurred with our recommendations, which will be closed upon completion and verification of corrective actions. This report contains non-public information about the SEC's examination program. We redacted the non-public information to create this public version.

WHAT WE FOUND

With its limited resources, EXAMS requires planning and risk assessment processes to identify entities and industry activities that pose a higher risk and to plan and scope broker-dealer examinations accordingly. However, BDX's broker-dealer examination metrics and planning appear too focused on numerical targets, and managers and staff could better document and monitor risk information in planning and scoping activities.

For example, we surveyed SEC managers and staff involved in broker-dealer examinations and about 45 percent of survey respondents agreed or strongly agreed that the quality and/or scope of broker-dealer examinations is negatively impacted in an effort to meet numerical targets. Further, the BDX records we reviewed did not always demonstrate that BDX management and examiners considered risk assessment data or other risk and priority areas when selecting exam candidates and scoping examinations.

This occurred because BDX (1) lacks program goals and objectives to help provide direction for more comprehensive planning, risk assessment, and monitoring; and (2) did not establish formal program-specific metrics or engage in the type of meaningful performance measurement and evaluation activities described in recognized leading practices. As a result, EXAMS may be unintentionally promoting practices that do not align with its stated risk-based approach. For example, we observed frequent limited scope broker-dealer examinations and waivers for important asset verification procedures. Focusing on limited scope areas and waiving asset verification may be suitable and appropriate depending on the circumstances. However, because EXAMS does not comprehensively monitor its use of limited scope examinations, asset verification waivers, or generally whether completed examinations aligned with identified program risks, it is not evident whether broker-dealer examinations are adequately covering high-risk entities and industry activities as intended.

We also reviewed a sample of 121 broker-dealer examinations and concluded that EXAMS generally complied with policies, procedures, and controls for performing and documenting examinations and key decisions. However, we identified areas for potential improvement related to internal controls and examination processes. For example, some information related to examination scope and risk ratings assigned to regulated entities was inconsistent, incomplete, or inaccurate as EXAMS either did not implement or could further improve relevant internal procedures and guidance. Improved examination information would further help EXAMS evaluate program performance, make informed decisions, and address the aforementioned issues with BDX's broker-dealer examination planning and performance measurement.

EXAMS, led by the current Director (appointed in May 2022) and including the BDX National Associate (appointed in May 2023) is working to implement program improvements. Among other things, EXAMS has undertaken or commenced efforts to assess the BDX program and its long-term planning efforts, develop improved performance metrics, and update internal controls and guidance to improve the quality of broker-dealer information and enhance planning and monitoring. We are encouraged by these actions and additional plans to address our findings.

Contents

Executive Summary	i
Abbreviations	iii
Background and Objectives	1
Background	1
Objectives	2
Results	4
Finding 1. Enhanced Performance Measurement and Evaluation Can Help EXAMS Avoid Unintentionally Promoting Practices That Do Not Align With a Risk-Based Approach	4
Recommendations, Management's Response, and Evaluation of Management's Response	10
Finding 2. Broker-Dealer Examinations Generally Complied With Policies and Procedures, But Some Information Could Be Improved.....	13
Recommendations, Management's Response, and Evaluation of Management's Response	16
Appendices	18
Appendix I. Scope and Methodology	18
Appendix II. Management Comments.....	23

Tables and Figures

Figure 1. Main Phases of the Examination Process	1
Figure 2. Annual Average Number of Broker-Dealer Examinations Completed by SEC Office Between FYs 2020 and 2023	2
Table 1. Closed Broker-Dealer Examinations (FY 2020 – FY 2023)	19
Table 2. Sample of Closed Broker-Dealer Examinations Initiated in TRENDS Cloud (FY 2021 – FY 2023)...	19

Abbreviations

BDX	Broker-Dealer and Exchange examination program
EXAMS	Division of Examinations
FINRA	Financial Industry Regulatory Authority
FY	fiscal year
GAO	U.S. Government Accountability Office
OIG	Office of Inspector General
SEC, agency, or Commission	U.S. Securities and Exchange Commission
TCR	tips, complaints, and referrals
TRENDS or TRENDS Cloud	Tracking and Reporting Examination National Documentation System

Background and Objectives

BACKGROUND

To help protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation, the U.S. Securities and Exchange Commission's (SEC or agency) Division of Examinations (Division or EXAMS) conducts thousands of examinations each year of securities market participants, including broker-dealers. Broker-dealers (totaling about 3,400 as of July 2024) handle trades between those buying and selling securities and provide services, such as recommending securities transactions and investment strategies involving securities, to assist investors with significant financial decisions.¹ Broker-dealers generally must register with the SEC and become a member of the Financial Industry Regulatory Authority (FINRA).²

SEC Broker-Dealer Examinations. When planning and performing examinations, EXAMS adheres to its “four-pillar” mission to promote compliance, prevent fraud, monitor risk, and inform policy. Examination results also help the SEC improve industry practices and pursue misconduct. EXAMS’ Broker-Dealer and Exchange examination program (BDX)—staffed with 168 employees as of March 2024—generally follows the process shown in Figure 1 to examine broker-dealers and other entities. Guided by the Division’s Exam Manual, examination staff seek to determine whether examined entities are (1) complying with federal securities laws and applicable rules; (2) adhering to disclosures made to clients, customers, the general public, and/or the SEC; and (3) implementing supervisory systems and/or policies and procedures reasonably designed to ensure compliance with applicable legal requirements. Among other topics, BDX’s broker-dealer examinations may focus on firms’ trading practices and compliance with financial responsibility rules and other regulations.³

Figure 1. Main Phases of the Examination Process



Source: Office of Inspector General (OIG)-generated based on information from the Exam Manual (June 6, 2023) and TRENDS guidance.

¹ As defined in the Securities Exchange Act of 1934, a “broker” is any person engaged in the business of effecting transactions in securities for the account of others, while a “dealer” is any person engaged in the business of buying and selling securities for such person’s own account, through a broker or otherwise. (15 U.S.C. §§ 78(c)(a)(4)(A) and (a)(5)(A) (Definitions and Application)). Adopted on February 6, 2024, rules 3a5-4 and 3a44-2 under the Securities Exchange Act of 1934 further identify certain activities that would cause market participants engaging in such activities to be “dealers” or “government securities dealers” and, as a result, be required to register with the SEC, become members of a self-regulatory organization, and comply with federal securities laws and regulatory obligations.

² FINRA is the not-for-profit self-regulatory organization authorized by Congress to oversee broker-dealers. FINRA writes and enforces rules governing the ethical activities of all registered broker-dealer firms and registered brokers in the U.S., examines firms on a set cycle (at least once every four years), fosters market transparency, and educates investors. FINRA is registered with the SEC as a national securities association, and EXAMS oversees its operations and programs and coordinates with FINRA, as appropriate, including on examination referrals.

³ For example, Regulation Best Interest, which was an examination priority during the period we reviewed, establishes the standard of conduct for broker-dealers when they recommend securities transactions or investment strategies involving securities. For additional information, see the risk alert issued on January 30, 2023, at <https://www.sec.gov/file/exams-reg-bi-alert-13023.pdf>.

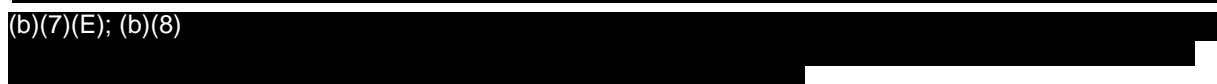
EXAMS uses the Tracking and Reporting Examination National Documentation System (TRENDS or TRENDS Cloud) to organize and record its examination activities. EXAMS staff at the SEC's headquarters and 10 regional offices completed 1,352 broker-dealer examinations between fiscal year (FY) 2020 and FY 2023 (that is, October 1, 2019, to September 30, 2023), averaging about 338 examinations each year. BDX staff conducted over 90 percent of these examinations.⁴

Figure 2. Annual Average Number of Broker-Dealer Examinations Completed by SEC Office Between FYs 2020 and 2023

(b)(7)(E); (b)(8)



(b)(7)(E); (b)(8)



Priorities, Initiatives, and Performance Goals. Each year, EXAMS releases a public statement to inform investors and registrants of the key risks and examination topics that the Division plans to prioritize.⁵ Additionally, EXAMS' leadership approves thematic initiatives involving a series of related examinations of multiple entities to examine priority issues, target certain practices, assess compliance with selected laws and rules, and/or assess the industry's response to particular events, among other things. The SEC also publicly releases annual performance plans and performance reports required by laws and regulations regarding strategic planning and performance. These performance reports include two goals for EXAMS' broker-dealer examinations with the following metrics: (1) the percentage of broker-dealers examined during the year, and (2) the number of examinations (to include broker-dealer examinations) that request information related to an entity's information security.⁶

OBJECTIVES

Our overall objective was to determine whether EXAMS was effectively overseeing its broker-dealer examinations. Specifically, we sought to determine whether EXAMS:

⁴ Other groups within EXAMS also examine broker-dealers, including when entities are dually registered as broker-dealers and investment advisers/investment companies and for compliance with rules that help address technological vulnerabilities in the U.S. securities markets.

⁵ See EXAMS' 2024 examination priorities at <https://www.sec.gov/files/2024-exam-priorities.pdf>.

⁶ The first performance metric separately tracks broker-dealer examination data; however, the second performance metric does not. These performance metrics (also referred to as goals, indicators, or measures) support SEC strategic goals and initiatives related to protecting the investing public from fraud, manipulation, and misconduct and addressing risks faced by the capital markets, respectively.

1. effectively used risk-based strategies in the selection and scoping of broker-dealer examinations;
2. performed and documented broker-dealer examinations in accordance with applicable policies and procedures; and
3. monitored and assessed results of examinations to enhance oversight of broker-dealer compliance and accurately measure EXAMS' performance.

We focused on processes, policies, and activities from FY 2020 through FY 2023. Appendix I of this report includes additional information about our scope and methodology, our review of relevant internal controls, and prior coverage.

Results

FINDING 1. ENHANCED PERFORMANCE MEASUREMENT AND EVALUATION CAN HELP EXAMS AVOID UNINTENTIONALLY PROMOTING PRACTICES THAT DO NOT ALIGN WITH A RISK-BASED APPROACH

With its limited resources, EXAMS requires BDX regional offices to develop exam plans and follow a risk assessment process to identify entities and industry activities that pose a higher risk and to plan and scope broker-dealer examinations accordingly.⁷ Given the fundamental importance of ensuring the safety of client assets, EXAMS also presumes that examination staff will verify the existence and integrity of client assets managed or held by all examined entities unless certain circumstances apply.⁸ Such asset verification measures also help determine whether certain information provided to examination teams and clients is accurate. Nonetheless, BDX's broker-dealer examination metrics and planning—including which entities it selects to examine and how it scopes examinations (generally the first two phases of the examination process depicted in Figure 1 on page 1 of this report)—appear too focused on numerical targets. Additionally, managers and staff could better document and monitor risk information in examination planning activities. This occurred because EXAMS lacks BDX program goals and objectives and did not engage in meaningful performance measurement and evaluation activities, which drive desired outcomes. As a result, EXAMS may be unintentionally promoting practices that do not align with its stated risk-based approach. For example, we observed frequent limited scope broker-dealer examinations and asset verification waivers during our review. Without clear linkage to identified BDX risks and comprehensive monitoring, it is not evident whether broker-dealer examinations are adequately covering high-risk entities and industry activities as intended.

BDX Examination Metrics and Planning Appear Too Focused on Numerical Targets

Federal agencies must establish annual plans and performance goals and publish updates on achievements.⁹ The U.S. Government Accountability Office (GAO) has identified leading practices for successful agency performance measurement and evaluation, noting among other things that (1) successful performance measures are outcome-based, informative, clear, and linked to agency goals and mission, and (2) program evaluation helps drive potential change by determining whether a program

⁷ Exam Manual § 21, (b)(7)(E); (b)(8), establishes the standards and processes EXAMS uses to select regulated entities to examine; § 21.06 is specific to BDX. In addition, § 21.02, (b)(7)(E); (b)(8), lists categories and sources of information that may be relevant when assessing risk, which should be considered along with EXAMS' annual statement of priorities and localized knowledge of entities to determine the most appropriate candidates for examination.

⁸ Section 8 of the Exam Manual addresses asset verification during broker-dealer and investment adviser examinations. § 8.01, (b)(7)(E); (b)(8)

⁹ As required by the GPRA Modernization Act of 2010, the update to GPRA, or the Government Performance and Results Act, which authorized a Federal Performance Framework in 1993 and sought to promote improved federal management and greater efficiency and effectiveness by requiring that agencies set goals and report annually on performance. According to the 2010 update, agency performance plans must also describe how performance goals are to be achieved, contribute to the agency's strategic plan, and establish a balanced set of performance indicators to be used in measuring or assessing progress towards each goal, among other things. (P. L. 111-352).

is working and why.¹⁰ EXAMS' goal is to examine about 45 percent of broker-dealers each year, and the Division met its goal between FYs 2020 and 2023.¹¹ However, EXAMS does not have a broker-dealer performance goal that incorporates other measures related to the Division's four-pillar mission.

We surveyed SEC managers and staff involved in broker-dealer examinations and, while about 78 percent of survey respondents agreed or strongly agreed that EXAMS effectively uses risk-based strategies in the selection and scoping of broker-dealer examinations, many also indicated a management emphasis on the quantity of examinations conducted versus examination quality or risk.¹² Specifically, about 45 percent of survey respondents agreed or strongly agreed that the quality and/or scope of broker-dealer examinations is negatively impacted in an effort to meet numerical targets. We also questioned survey participants about what, in their experience, drives the number of broker-dealer examinations performed annually. The answer most frequently selected (by 31 percent of respondents) was SEC performance goals which measure the percentage of broker-dealers examined, followed by risk assessments (22 percent), annual examination priorities (21 percent), and BDX workload goals (20 percent).

Regarding the focus on numerical examination targets, 48 EXAMS employees provided 90 additional comments on this topic. One employee stated that the "[p]rimary driver is the number of exams period. There is no real risk discussion." Another stated, "The [examination] scope areas appear to be selected based on the ability to meet exam target numbers instead of identifying actual high risk issues and/or conducting quality examinations." We were also told that, "[e]ach year [examiners] are expected to conduct slightly more exams than [sic] the previous year. With a risk based approach the focus should not be on a [sic] numbers, but the quality or novelty of areas we could be looking into to." Yet another employee stated, "It appears that a bulk of our workload revolves around achieving statistics rather than generating more quality, risk-based sales practice examinations. It is difficult to ascertain how exams are selected... I believe we could conduct more meaningful exams in support of the mission to better care for the retail investor. However, that would require better exam selection processes, appropriate scoping, and the agency's acknowledgment that the quality of the exam is more important than quantity of exams."

In FY 2023, EXAMS established an updated BDX planning process wherein the National Examination Program Office at the SEC's headquarters provided each regional office with an estimated number of examinations to accomplish, and the regional offices submitted exam plans in response. As one survey respondent commented, "Number of [broker-dealer] exams that our regional office is expected to do appears to be based on national BDX leadership assigning a number to our region."

¹⁰ U.S. Government Accountability Office, *Program Evaluation Key Terms and Concepts* (GAO-21-404SP, March 2021); *Performance Measurement and Evaluation* (GAO-11-646SP, May 2011); *Securities Regulation: SEC Could Take Further Actions to Help Achieve Its FINRA Oversight Goals* (GAO-22-105367, December 2021); and *TAX ADMINISTRATION: IRS Needs to Further Refine Its Tax Filing Season Performance Measures* (GAO-03-143, November 2002).

¹¹ SEC reporting for this metric does not distinguish between the number of examinations conducted by the SEC versus FINRA. Although the metric's description states that it includes broker-dealer examinations conducted by EXAMS or a self-regulatory organization, it may be unclear to agency stakeholders that most of the examinations included in the metric each year are conducted by FINRA. Specifically, the SEC and FINRA examined a combined average of (b)(8) broker-dealers between FY 2020 and FY 2023, yet firms examined *only* by FINRA averaged about (b)(8) percent; firms examined *only* by the SEC averaged about (b)(8) percent; and firms examined by both regulators averaged about (b)(8) percent.

¹² Appendix I describes our survey methodology and response rate.

Opportunities Exist To Better Document and Monitor Risk Information

In addition to EXAMS' focus on numerical examination targets, records we reviewed demonstrated that EXAMS management and staff can better document how risk factored into broker-dealer examination planning activities. The Exam Manual requires that BDX offices conduct a risk assessment, as discussed in § 21.02, and complete annual exam plans, which undergo periodic reviews.¹³ These policies also detail factors staff should consider when assessing risk and determining whether an exam should be conducted. Regional and program personnel are responsible for evaluating risk as it relates to potential exam candidates, and other offices within EXAMS (including the Office of Risk and Strategy) help guide the risk assessment process.¹⁴ BDX management uses Office of Risk and Strategy broker-dealer planning data, along with numerous other data sources and input from various internal and external stakeholders, to identify current industry risks.¹⁵ However, BDX could have a more detailed policy requiring staff to also create or maintain minimum sources of information (such as Office of Risk and Strategy data) to be used in exam planning, risk assessment, and the examination selection process.

The BDX records we reviewed, comprised of exam plans and TRENDS files, did not always demonstrate that BDX management and examiners considered risk assessment data or other risk and priority areas when selecting exam candidates and scoping examinations. Although some BDX offices had documentation regarding risk assessment and examination selection processes, how BDX exam plans linked to identified program risks could be clarified.¹⁶ While not required by policy, many exam plans, particularly from FY 2023, did not include the reason(s) for candidate selection, staff resources, timeframes, related priorities, information from previous or planned FINRA examinations, or other information that would be beneficial to understand and assess how risk factored into examination planning. A notable exception was (b)(7)(E); (b)(8), which has a written risk monitoring framework and often included in exam plans specific citations to Office of Risk and Strategy data and risk model ratings to explain examination selection decisions.¹⁷ Other BDX offices could benefit from similar processes.

Furthermore, despite the extensive data available from the Office of Risk and Strategy, EXAMS' annual Division-wide priorities, and other information sources, EXAMS management also did not comprehensively monitor whether broker-dealer examinations covered the higher risk entities, industry activities, and the priorities identified during examination planning. As discussed in Finding 2 of this

¹³ Exam Manual, § 21.06, (b)(7)(E); (b)(8)

¹⁴ Exam Manual, § 21.02, (b)(7)(E); (b)(8) For example, to assist with examination planning each year, the Office of Risk and Strategy compiles and makes available the most relevant financial and qualitative data about broker-dealers registered with the SEC.

¹⁵ According to an EXAMS official, in mid-2023 EXAMS implemented a consolidated broker-dealer risk assessment framework to compile broker-dealer registrant risks from different sources into one list; previously, there were many separate frameworks by topic. However, the consolidated framework was put on hold in fall 2023 so that the newly appointed National Risk Strategist could assess the framework and BDX processes more generally.

¹⁶ Although not required, BDX personnel at (b)(7)(E); (b)(8) prepared annual examination plan memoranda for FY 2020 through FY 2023 and the (b)(7)(E); (b)(8)—the regional office that conducts the most BDX examinations each year—summarized its BDX risk monitoring framework in a 2022 memorandum. (b)(7)(E); (b)(8) also maintained examination selection summaries and BDX established an exam selection, scheduling, and staffing process in 2016.

¹⁷ (b)(7)(E); (b)(8) completed (b)(7)(E); (b)(8) percent of all broker-dealer examinations in FY 2023.

report, incomplete, inconsistent, or inaccurate examination information may have hindered such monitoring had it been a management priority.

Finally, EXAMS did not assess the extent of broker-dealer examinations conducted under specialized thematic initiatives.¹⁸ These initiatives typically focus on limited scope areas or specific practices, compliance with new SEC rules, specific aspects of compliance or the industry's response to particular events, and/or annual examination priorities. (b)(7)(E)

Therefore, tracking staff's use of thematic initiatives as a component of EXAMS' larger broker-dealer examination program may help management determine whether such initiatives are supporting the Division's risk-based strategies and four-pillar mission.

BDX Lacks Program Goals and Objectives and Management Can Improve Its Use of Readily Available Data

Despite EXAMS' Division-wide goals, BDX lacks program goals and objectives to help provide direction for more comprehensive BDX program planning—to include risk assessment—and monitoring. BDX management also has access to a dashboard which allows for visualization of examination data from TRENDS, including data about examinations that result in deficiency letters, referrals to the SEC's Division of Enforcement, and significant findings in examinations. Even with such detailed, outcome-oriented information available for its use, during the period we reviewed BDX management did not establish formal program-specific metrics or engage in the type of meaningful performance measurement and evaluation activities described in recognized leading practices.

In addition, until FY 2023, broker-dealer examination planning was decentralized and left mostly to the SEC's regional offices. As previously stated, there was no policy for documenting BDX risk assessment processes, and BDX offices used various frameworks and formats for selection decisions. While we acknowledge that regional expertise is important, formal program goals and objectives focused on desired outcomes would ensure more consistent examination planning and that BDX's broker-dealer examinations fully support the Division and agency's mission. As some respondents to our survey noted, BDX operates in a unique regulatory environment where both the SEC and FINRA have broker-dealer oversight responsibilities. This creates opportunities to more strategically plan and leverage examination results to assess risk and apply the Division's limited resources accordingly.

BDX Planning Activities and Performance Data Need Improvement To Demonstrate Coverage of High-Risk Entities and Activities

Management's focus on examination quantities and a need for better documentation and monitoring of examination planning activities may unintentionally promote practices that do not align with EXAMS' risk-based approach. This could include examinations that limit scope without due consideration of high-risk areas, permit waivers of otherwise required processes, address less complex topics, and otherwise do

¹⁸ Exam Manual § 20, (b)(7)(E); (b)(8) Examples of thematic initiatives in our review period included digital assets, cyber security, market volatility, and compliance with Regulation Best Interest.

not adequately consider risk or Division priorities. We reviewed records of completed broker-dealer examinations and observed frequent limited scoping and use of asset verification waivers, as discussed below. Because BDX does not comprehensively monitor its use of limited scope examinations, asset verification waivers, or generally whether broker-dealer examinations align with identified program risks, it is not evident whether these examinations are adequately covering high-risk entities and industry activities as intended.

Limited Scope Examinations. About (b)(7)(E); (b)(8) of the 121 examinations that we judgmentally selected for review had a limited scope.¹⁹ Specifically, (b)(7)(E); (b)(8) examinations were part of thematic initiatives that covered specific scope areas and generally waived asset verification as permitted by Division policy.²⁰ Just over (b)(7)(E); (b)(8) other examinations were described in examination files as having a limited scope or narrow focus. Examples of limited scope examinations included those focused on firms with potential regulatory filing issues, those that address tips, complaints and referrals (TCRs), those that followed up on past deficiencies, or those that supported efforts to help plan and assess risk for investment adviser/investment company examinations. While focusing on limited scope areas may be suitable and appropriate depending on the circumstances, it is unclear whether and to what extent a focus on numerical targets may be inadvertently influencing such decisions. For example, examinations in our sample that we later learned were associated with a (b)(8) project required minimal staff hours, resulted in no deficiencies identified, lacked documentation, and required no exit conferences with examined entities.²¹ We questioned whether such efforts should have been characterized as examinations because, compared to traditional examinations, they produced minimal information. Expanding our review to all broker-dealer examinations completed between FY 2020 and FY 2023, EXAMS confirmed that three regional offices conducted a total of (b)(8) reviews associated with (b)(8) or similar projects during that time and that it was more appropriate to report such efforts as “matters under consideration” than “examinations.”

Asset Verification Waivers. In addition, about (b)(7)(E); (b)(8) percent of the 121 examinations we reviewed, including those that were not characterized as limited scope, involved no or limited asset verification. EXAMS management officials fully waived asset verification for (b)(7)(E); (b)(8) of these examinations and partially waived it for the remaining (b)(7)(E); (b)(8) examinations.²² Notably, the majority of respondents to our survey (124 of 148, or about 84 percent) felt that the extent of asset verification performed was appropriate or too high for the examinations they conducted or managed. Although waiving asset verification may be suitable and appropriate depending on the circumstances, frequent asset verification waivers may be detrimental to the SEC’s mission, and EXAMS management should further review its practices and

¹⁹ Appendix I describes our sampling methodology.

²⁰ This total does not include sampled examinations associated with an “overlay” thematic initiative, which adds a focus area to examinations already in progress.

²¹ After we alerted the EXAMS Office of Chief Counsel of these findings in January 2024, (b)(7)(E); (b)(8) management began uploading documents to related TRENDS examination files, noting that the missing documents were an oversight.

²² (b)(7)(E); (b)(8)

policies to ensure alignment with EXAMS' risk-based strategies. Some survey respondents offered suggestions for improvement or highlighted the need to determine whether asset verification is necessary. For example, one respondent stated that the broker-dealer "...program could be more thoughtful and targeted in doing its [asset verification]."

Responses to our survey of EXAMS managers and staff also warned that management's focus on meeting numerical targets may cause unintended consequences. For example, one employee noted that a constant focus on exam numbers may lead to unintended behaviors and that such a focus, coupled with insufficient resources, may drive EXAMS away from its core mission. Other employees reported conducting "easier" examinations to meet numerical targets. In one example, a respondent commented, "Due to the focus on exam numbers, there is a risk that exams are too narrowly focused (commonly referred to as quick hit exams). There is a risk that we are placing too much emphasis on the ease with which to complete exams or wanting to cover a certain percentage of broker-dealer exams rather than focusing on the more prevalent risks and issues." EXAMS management explained that limited scope examinations provide critical insight into firms and that many limited scope examinations are focused on national priorities and TCRs, both of which are focused on risk. Management also noted that examination staff should broaden the scope of an examination, subject to supervisory approval, if they identify additional risk areas in the firm's operations.²³

Overall, EXAMS could benefit from less focus on numerical targets and more comprehensive planning based on outcome-oriented BDX program goals and objectives, particularly in light of BDX's limited staff resources.²⁴ In fact, many survey respondents (about 48 percent) generally disagreed that EXAMS' human capital resources are sufficient to handle the current broker-dealer workload, which may be impacted by rules adopted in February 2024.²⁵ One employee stated, "In my opinion this area of the program doesn't have enough resources to meet the program workload. This impacts the program in a multitude of ways which is exacerbated by the focus on meeting certain exam goals per year."

Further, according to SEC guidance, providing meaningful, reliable, and accurate performance data to help the agency achieve its strategic goals and initiatives significantly enhances leadership's decision-making.²⁶ Without improvements, EXAMS' broker-dealer examination performance metrics may not

²³ Exam Manual, § 5.06, (b)(7)(E); (b)(8)

²⁴ In a 2016 reorganization, with the goal to increase investment adviser/investment company examination coverage, EXAMS reallocated BDX staff to the Investment Adviser/Investment Company examination program. At the same time, BDX gained market oversight responsibilities. Realizing an increased dependence on FINRA for examining broker-dealers, EXAMS established a dedicated group to focus on FINRA oversight, to include assessing FINRA's operations.

²⁵ By April 29, 2025, market participants that engage in activity under new rules 3a5-4 and 3a44-2—which further define the phrase "as a part of a regular business" as used in the statutory definitions of "dealer" and "government securities dealer" under sections 3(a)(5) and 3(a)(44), respectively, of the Securities Exchange Act of 1934—must register with the SEC, become members of a self-regulatory organization, and comply with the related federal securities laws and regulatory obligations. While the exact impact on EXAMS' broker-dealer workload may be difficult to estimate at this time and estimates of the number of affected parties are subject to significant caveats, addressing the issues raised in our report could help EXAMS better fulfill its responsibilities under the new rules.

²⁶ SEC Administrative Regulation 3-3, *Strategic Planning and Performance Metrics Reporting*, and the supplemental (b)(8) outline guidance to achieve complete and reliable performance data.

provide useful information for stakeholders and other decision-makers as to whether the Division is achieving effective broker-dealer oversight.

During our evaluation, EXAMS senior management, including its Director and Deputy Director, stated that updating EXAMS' performance goals has been raised in the past and management is reassessing the goals and metrics for the Division and its program areas. Furthermore, in January 2024, the Division established a Performance Metrics Project Team, led by the Deputy Director and comprised of supervisors from all five examination program areas, with the goal of selecting the right framework to measure performance and adopt metrics that help manage the work of EXAMS and assess its effectiveness.

We acknowledge that numerical targets can be useful performance metrics when evaluated alongside other outcome-oriented metrics, and developing outcome-oriented performance metrics can be challenging. However, engaging in performance measurement and evaluation activities that are more consistent with leading practices will help EXAMS track progress toward achieving goals, objectives, and priorities and offer more useful information for stakeholders and other decision-makers. EXAMS leadership identified that it could improve the way it develops numerical targets and has been working to develop a methodology for numerical targets that is more risk-based.²⁷

EXAMS, led by the current Director (appointed in May 2022) and including the BDX National Associate (appointed in May 2023), is holistically assessing the BDX program and thinking strategically about BDX long-term planning. Recent changes include hiring a new Senior Officer to oversee BDX's examination program at the SEC's headquarters (previously a responsibility of the BDX National Associate) and appointing the Division's first BDX National Risk Strategist to view risks across the regions. The National Risk Strategist is tasked with serving the entire BDX program as a national resource on risk assessment and exam planning, to include coordinating with personnel from regional offices, the Office of Risk and Strategy, other SEC divisions and offices, and FINRA. According to EXAMS, the National Risk Strategist (hired in October 2023) has initiated several projects—to include analyzing the broker-dealer population by risk categories and assessing FINRA's examination coverage to determine potential gaps between BDX and FINRA—and envisions developing a more formal risk assessment process for EXAMS. We are encouraged by management's actions and stated plans, noting that effectively employing risk-based strategies for broker-dealer examination planning is more critical than ever given EXAMS' limited resources.

RECOMMENDATIONS, MANAGEMENT'S RESPONSE, AND EVALUATION OF MANAGEMENT'S RESPONSE

We recommend that the Division of Examinations:

²⁷ EXAMS is developing a new methodology that ties the targeted number of exams to be completed each year to the availability of staff resources and the Division's assessment of the operating environment. The methodology will focus on selecting firms to examine that exhibit key risks identified by the Division. EXAMS leadership expects to begin using this methodology for determining FY 2026 projections.

Recommendation 1:

(a) Develop Broker-Dealer and Exchange examination program goals and objectives that reflect core mission areas; (b) establish Broker-Dealer and Exchange examination program performance metrics that align with established program goals and objectives and are based on recognized leading practices (that is, are outcome-based, informative, clear, and linked to agency goals and mission); and (c) develop Broker-Dealer and Exchange examination program evaluation and monitoring activities that consider performance metric data and are based on recognized leading practices (that is, activities that help drive potential change by determining whether the program is working and why).

Management's Response. Management concurred with the recommendation. According to EXAMS' Acting Director, EXAMS will develop BDX goals and objectives, establish BDX performance metrics that align with these goals and objectives and are based on recognized leading practices, and develop a plan for evaluation and monitoring activities that consider performance metric data and are based on recognized leading practices. Management's complete response is reprinted in Appendix II.

OIG's Evaluation of Management's Response. Management's proposed actions are responsive. The recommendation will be closed upon completion and verification of the proposed actions.

Recommendation 2:

Conduct a comprehensive review of the following topics as part of ongoing efforts to improve the Broker-Dealer and Exchange examination program, and establish appropriate corresponding corrective action(s):

- a. Examination scoping practices holistically, to include the use of limited scope examinations (such as thematic initiatives).
- b. Alignment of examinations with annual priorities, industry activities, and risks identified in broker-dealer planning data.
- c. Extent of asset verification performed and waivers authorized.
- d. Broker-dealer examination coverage of the Financial Industry Regulatory Authority and how it may be leveraged in program planning.

Management's Response. Management concurred with the recommendation. According to EXAMS' Acting Director, EXAMS will conduct a comprehensive review of the topics listed above to improve the BDX program and establish corresponding corrective action. Management's complete response is reprinted in Appendix II.

OIG's Evaluation of Management's Response. Management's proposed actions are responsive. The recommendation will be closed upon completion and verification of the proposed actions.

Recommendation 3:

Require that exam plans or other planning memoranda contain more detailed information about the process used to select broker-dealer examination candidates and the reason(s) for selection to help support that risk-based strategies were used.

Management's Response. Management concurred with the recommendation. According to EXAMS' Acting Director, EXAMS will update policies related to broker-dealer exam planning to generally require regional offices to memorialize in writing their risk-based process used to select examination candidates and the reason(s) for selection, taking into consideration variances among the regional offices in the size and staffing levels of their broker-dealer examination program. Management's complete response is reprinted in Appendix II.

OIG's Evaluation of Management's Response. Management's proposed actions are responsive. The recommendation will be closed upon completion and verification of the proposed actions.

FINDING 2. BROKER-DEALER EXAMINATIONS GENERALLY COMPLIED WITH POLICIES AND PROCEDURES, BUT SOME INFORMATION COULD BE IMPROVED

Federal internal control standards state that management should use quality information—information that is, among other things, appropriate, complete, and accurate—to achieve the entity’s objectives.²⁸ With regard to EXAMS, examination information stored in TRENDS forms the principal record of the Division’s work throughout each phase of an examination. These records may be reviewed and relied on by other examination staff, supervisors, other select Commission staff, and the OIG and GAO. Therefore, EXAMS personnel must take care to record complete, consistent, and accurate examination information.²⁹ We reviewed files for the 121 examinations in our sample and concluded that, generally, BDX’s broker-dealer examinations complied with key requirements tested. However, in some cases, information related to examination scope (including basic examination setup information and whether asset verification was performed) and risk ratings assigned to regulated entities was incomplete, inconsistent, or inaccurate.

Broker-Dealer Examination Records Generally Complied With Policies and Procedures

We assessed whether examinations in our sample complied with key examination performance and documentation requirements and controls established in the Exam Manual, TRENDS guidance, and EXAMS’ risk and control matrices. Overall, we observed that examiners documented required information for each examination phase and accurately recorded dates related to statutory timeframes. Sampled examinations included appropriate and timely approvals, staff groups and offices created required annual exam plans, and thematic initiatives generally met requirements for documenting scoping decisions, approvals, and finding summaries.

Staff Did Not Always Properly Record Certain Examination Information

Once an examination team gathers relevant background information and gains a thorough understanding of an entity’s business model, operations, management and control structure, and other factors that may pose compliance risks, EXAMS personnel establish the appropriate examination scope (steps completed in the first two phases of the examination process depicted in Figure 1 on page 1 of this report). Establishing the scope is a critical step in planning an examination and ensuring the examination efficiently and effectively achieves desired goals and appropriately addresses risk. Section 5 of the Exam Manual, (b)(7)(E); (b)(8), requires staff to ensure scoping decisions are reflected in TRENDS. Furthermore, before the examination concludes, examiners should consider and determine risk ratings for the regulated entity or explain if they are unable to make a determination. These ratings may inform future examination planning. Because EXAMS either did not implement or could further improve relevant

²⁸ U.S. Government Accountability Office, *Standards for Internal Control in the Federal Government* (GAO-14-704G, September 2014); Principle 13, *Use Quality Information*.

²⁹ The importance of maintaining complete, accurate examination records is discussed throughout the Exam Manual and certain sections emphasize the need to properly record specific examination information. These include but are not limited to § 5.04, (b)(7)(E); (b)(8); § 8.02B, (b)(7)(E); (b)(8); § 10.15, (b)(7)(E); (b)(8); § 13.03, (b)(7)(E); (b)(8); and § 20.03, (b)(7)(E); (b)(8); (b)(7)(E); (b)(8).

internal procedures and guidance, staff did not always properly record in TRENDS information that would provide a complete and accurate understanding of important aspects of examination scope and entity risk. The sections that follow describe specific issues we identified.

Examination Setup Information. Among other things, examination setup information should accurately explain Division-level priorities addressed by each examination, any thematic initiatives covered, and the type of examination being conducted. However, official records for 50 of the 121 examinations we reviewed (or about 41 percent) did not include priority information even though established Division-level priorities appeared to have applied in some cases. For example, some examinations that clearly featured Regulation Best Interest or net capital computations as part of the scope did not list these areas as priorities in TRENDS. Other examinations listed outdated priorities because those options were not removed timely from the system and remained available for staff to select. Also, EXAMS staff mislabeled thematic initiative information for 15 of the 35 examinations we reviewed that included thematic initiatives (or about 43 percent). Furthermore, examination type information was mislabeled or another selection appeared more appropriate for about 45 percent of the 121 files we reviewed.

Asset Verification Information. Examination teams could more consistently document decisions about asset verification. For example, examiners did not include sufficient information in TRENDS to determine whether asset verification was waived or partially waived for (b)(7)(E); (b)(8) examinations we reviewed (or (b)(7)(E); (b)(8) percent).³⁰ Additionally, asset verification waivers that covered several examinations were included in one file but not in others. EXAMS staff also documented the scope of asset verification work differently and, in some cases, it may be unintentionally misleading. As detailed in Finding 1, asset verification was fully waived for (b)(7)(E); (b)(8) of the 121 examinations we reviewed. However, in (b)(7)(E); (b)(8) of these (b)(7)(E); (b)(8) examinations, staff reported asset verification as “in scope” in the completed examination, even though a waiver was received and asset verification was not performed.³¹ For the remaining (b)(7)(E); (b)(8) of these (b)(7)(E); (b)(8) examinations where asset verification was fully waived, asset verification was not included as “in scope”.

Risk Rating Information. (b)(8)

(b)(8)

(b)(8)

(b)(8)

³² Overall, risk ratings are intended to capture the examination team’s view of the examined entity. Examination teams may either choose a specific risk rating or, if the team was not in a position to determine a rating, document that risk was “Not Rated.”³³ Staff may also add optional explanations to describe factors or limitations considered in their assessments of risk. In our sample of broker-dealer examinations, staff inconsistently established risk

³⁰ According to EXAMS, asset verification was waived for (b)(7)(E); (b)(8) of these examinations because (b)(7)(E); (b)(8) Approval to waive asset verification for the other (b)(7)(E); (b)(8) examinations should have been documented in TRENDS but was not.

³¹ In some sampled examinations, (b)(7)(E); (b)(8)

³² (b)(8)

³³ (b)(8)

ratings, particularly for examinations with limited scope. For instance, (b)(8)

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

EXAMS Lacked Adequate Internal Procedures and Guidance

Staff did not always properly establish certain examination information because EXAMS lacked adequate internal procedures and guidance. For example, Division guidance does not tell staff how to record priorities or examination types in TRENDS, particularly for broker-dealer examinations.³⁴ Additionally, TRENDS fields pertaining to priorities and thematic initiatives are optional, and some data available to populate examination setup fields are repetitive, outdated, or unclear. The Exam Manual also refers to an “OCIE Examination Guide: Asset Verification” document, dated February 2017, which is outdated.³⁵ Furthermore, the Exam Manual provides guidance for asset verification and risk rating reviews and approvals, but these reviews are based on specific examination files and do not look across a range of broker-dealer examinations. Unlike office-specific EXAMS management reviews, our review included examination files from various offices, staffing groups, and program areas; therefore, we identified issues regarding asset verification and risk ratings that may not have been evident to supervisors or higher-level personnel reviewing individual examination files.

Higher Quality Information Would Improve Examination Planning and Performance Monitoring

EXAMS managers occasionally use examination setup and scope information for ad hoc reporting, staff may consult risk ratings to inform future broker-dealer examination planning, and other internal and external stakeholders may review and rely on examination information stored in TRENDS. Therefore, it is important that such information is properly recorded. More complete, consistent, and accurate information overall could be used to monitor and assess how well examinations align with annual priorities, the extent of asset verification, or other examination activities over time. Until further improvements are made in addition to those already being addressed by Division leadership, EXAMS hinders its ability to better perform such holistic assessments and make data-driven decisions. Higher quality information would also help EXAMS address issues we identified with broker-dealer examination planning and performance measurement and evaluation, as discussed in Finding 1.

In response to our concerns and other ongoing reviews by the Division’s Compliance group, EXAMS has taken actions to improve the quality of certain examination information, to include examination setup

³⁴ Exam Manual § 14.04, (b)(7)(E); (b)(8) [REDACTED], discusses examinations initiated from a TCR, and § 18.04, (b)(7)(E); (b)(8) [REDACTED], explains corrective action reviews. According to EXAMS, although examiners can see the list of examination types when entering information in TRENDS, information is not made available to explain each type.

³⁵ “OCIE” refers to the Office of Compliance Inspections and Examinations, which was renamed EXAMS in December 2020. Additionally, the February 2017 guidance predates EXAMS’ transition to the TRENDS Cloud system and does not reflect current asset verification scoping procedures and recent updates to asset verification waiver decisions.

fields. For example, EXAMS published its annual priorities at the start of FY 2024, which makes it easier for examiners to align examinations to priorities in TRENDS. The Division also captured a list of approved thematic initiatives on its internal website. In August 2023, EXAMS updated the “examination type” reference data in TRENDS (the data staff may use to classify examinations) to remove several fields that were no longer in widespread use. Furthermore, in April 2024, EXAMS updated TRENDS to require examiners to complete the “program priorities” field before closing an examination.

EXAMS personnel also described planned actions that will help address some of the issues we identified. For example, EXAMS plans to update TRENDS to make completing thematic initiatives fields mandatory and strengthen processes for timely review and approval of updates to related TRENDS reference data. Furthermore, EXAMS leadership plans to reassess how BDX and possibly other program areas use examination types in TRENDS to identify potential areas for improvement, and the BDX National Associate plans to consider the utility of risk ratings for broker-dealer examinations. EXAMS acknowledged difficulties in determining the extent of asset verification performed based solely on the asset verification scope areas in TRENDS. To address these limitations, EXAMS officials are working on a more reliable tracking method, including adding a field that will ask examiners if asset verification was performed during the examination. EXAMS has also formed a management-level asset verification working group to review related policies and procedures. We are encouraged by these actions and additional plans to address our findings.

RECOMMENDATIONS, MANAGEMENT’S RESPONSE, AND EVALUATION OF MANAGEMENT’S RESPONSE

We recommend that the Division of Examinations:

Recommendation 4:

Establish guidance to assist examiners entering examination setup information—to include priorities, initiatives, and examination types—in TRENDS.

Management’s Response. Management concurred with the recommendation. According to EXAMS’ Acting Director, EXAMS will establish guidance to assist examiners entering examination setup information – to include priorities, initiatives, and examination types – in TRENDS. Management’s complete response is reprinted in Appendix II.

OIG’s Evaluation of Management’s Response. Management’s proposed actions are responsive. The recommendation will be closed upon completion and verification of the proposed actions.

Recommendation 5:

Finalize development of a process that will ensure timely approval and updates to TRENDS reference data related to priorities, thematic initiatives, and examination types.

Management’s Response. Management concurred with the recommendation. According to EXAMS’ Acting Director, EXAMS will finalize a process to ensure timely approval and updates to

TRENDS reference data related to program priorities, thematic initiatives, and examination types. Management's complete response is reprinted in Appendix II.

OIG's Evaluation of Management's Response. Management's proposed actions are responsive. The recommendation will be closed upon completion and verification of the proposed actions.

Recommendation 6:

Review and update, as appropriate, procedures and guidance relevant to asset verification and risk ratings to ensure recordkeeping in TRENDS is consistent across broker-dealer examination files, which may include incorporating reviews of this information across broker-dealer examinations.

Management's Response. Management concurred with the recommendation. According to EXAMS' Acting Director, EXAMS will review and update, as appropriate, the procedures and guidance relevant to the performance of asset verification and the identification of broker-dealer risk ratings to ensure recordkeeping in TRENDS is consistent across broker-dealer examination files. Management's complete response is reprinted in Appendix II.

OIG's Evaluation of Management's Response. Management's proposed actions are responsive. The recommendation will be closed upon completion and verification of the proposed actions.

Appendix I. Scope and Methodology

We conducted this evaluation from August 2023 to September 2024 in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation*. Those standards require that we plan and perform the evaluation to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings, conclusions, and recommendations based on our evaluation objectives. We believe that the evidence obtained provides a reasonable basis for our findings, conclusions, and recommendations based on our evaluation objectives.

Objectives and Scope

Our evaluation focused on processes, policies, and activities from FY 2020 through FY 2023. Our overall objective was to determine whether EXAMS was effectively overseeing its broker-dealer examinations. Specifically, we sought to determine whether EXAMS (1) effectively used risk-based strategies in the selection and scoping of broker-dealer examinations; (2) performed and documented broker-dealer examinations in accordance with applicable policies and procedures; and (3) monitored and assessed results of examinations to enhance oversight of broker-dealer compliance and accurately measure EXAMS' performance.

Methodology

To address our objectives, among other work performed, we:

- met with EXAMS and BDX leadership and staff to learn about the planning, performance, and monitoring of broker-dealer examinations;³⁶
- participated in walkthroughs of TRENDS and dashboards EXAMS uses to capture broker-dealer examination data;
- reviewed examination plans, performance data, and policies and procedures covering our scope period;
- tested a judgmental sample of 121 broker-dealer examinations to assess EXAMS' planning and compliance with key policies and procedures; and
- surveyed SEC managers and staff involved in broker-dealer examinations.

Sampling Methodology. As previously mentioned, EXAMS completed 1,352 broker-dealer examinations between FY 2020 and FY 2023. Our testing population included the 1,265 examinations that had a "closed" status.³⁷ BDX conducted over 90 percent of these examinations, as Table 1 shows. Additionally, in May 2021, EXAMS retired the legacy system used to organize and record examination

³⁶ We also reviewed a risk alert EXAMS published on June 5, 2024, to help broker-dealers prepare for examinations. The alert explained information staff may consider when selecting firms to examine and areas of focus for the exams. It also provided the types of information, including documents, staff may initially request.

³⁷ Examinations were considered "completed" if EXAMS sent a disposition letter although, in some cases, EXAMS may be awaiting an entity's response. Examinations are "closed" when the entity's response has been received and no further action is warranted.

activities and switched to TRENDS Cloud. To ensure our testing focused on current examination policies and procedures that were most representative of relevant practices, we further narrowed our population to those 578 closed broker-dealer examinations that were initiated in TRENDS Cloud. Using a report from TRENDS, we judgmentally selected about 21 percent of the 578 closed broker-dealer examinations for review, ensuring only that we selected examinations from each year and from each SEC office that conducted broker-dealer examinations that year. This yielded a total sample of 121 examinations, as Table 2 shows.

Table 1. Closed Broker-Dealer Examinations (FY 2020 – FY 2023)

EXAMS Group	Number of Closed Broker-Dealer Examinations						
	FY 2020	FY 2021	FY 2022	FY 2023	Average ¹	Total	Percentage of Total
BDX	303	295	304	240	286	1,142	90.3%
Other	24	32	57	10	31	123	9.7%
Total	327	327	361	250	316	1,265	100%

Source: OIG-generated based on the Approved Examinations Report generated from TRENDS Cloud. This data was accessed on October 20, 2023, thus will differ from the workload data publicly reported by EXAMS in its FY 2025 congressional budget justification.

Note 1: Numbers do not add to total due to rounding.

Table 2. Sample of Closed Broker-Dealer Examinations Initiated in TRENDS Cloud (FY 2021 – FY 2023)

SEC Office ¹	Number of Closed BDX Broker-Dealer Examinations							
	(b)(6)	(b)(7)	(b)(8)	(b)(9)	(b)(10)	(b)(11)	(b)(12)	(b)(13)
	(b)(6)	(b)(7)	(b)(8)	(b)(9)	(b)(10)	(b)(11)	(b)(12)	(b)(13)

(b)(8)

(b)(8)

For each examination included in our sample, we reviewed examination planning procedures, documentation of exam purpose and scope, and whether the exam was conducted under a stated Division priority or a national or regional thematic initiative. We also tested examination procedures and

controls related to the completion and review of various examination phases, supervisory review of asset verification waivers and changes to examination scope, exit conferences, risk ratings, examination referrals to other SEC divisions and external entities, and the mandated deadline to provide written notification that the examination has concluded, among others. Although our sample was non-statistical and our results cannot be projected to the total population for each test performed, the evidence we gathered helped support our findings, conclusions, and recommendations.

Survey Methodology. We issued an optional, web-based survey to the 394 current EXAMS managers and staff who were involved in broker-dealer examinations during the period we reviewed.³⁸ The survey included multiple choice questions and optional comment fields that sought to gather information about EXAMS' broker-dealer examination selection processes, coverage and numbers, policies and training, resources, coordination, and program performance. Of the 394 recipients, 192 completed the survey for a response rate of about 49 percent. Of those respondents, 148 indicated that they were involved in broker-dealer examinations to the degree that they could provide insight into actions to plan, conduct, and/or assess results of examinations. These individuals completed the remaining survey questions for an effective response rate of about 38 percent.

Internal Controls

We identified and assessed internal controls, applicable internal control components, and underlying principles significant to our objectives, as described below.

Control Environment. We assessed the control environment established by EXAMS' senior management. We reviewed EXAMS' organizational structure and interviewed staff responsible for reviewing and maintaining EXAMS' internal control documentation. We met with those responsible for overseeing broker-dealer examinations, including EXAMS' Director, Deputy Director, Associate and Assistant Directors, and Senior Counsel. We also met with EXAMS personnel tasked with monitoring, compiling, and reporting annual broker-dealer examination performance data.

Risk Assessment. We obtained and reviewed EXAMS' management assurance statements and risk control matrices from FY 2020 through FY 2023 to identify risks and controls related to the oversight of broker-dealer examinations. We assessed risks identified by EXAMS and reviewed annual control testing documentation and corrective action plans. We also reviewed a system security plan, security categorization worksheet, privacy impact assessment, and system authorization to operate document for TRENDS Cloud, as well as other TRENDS Cloud operating guidance.

Control Activities. We reviewed applicable federal guidance, SEC-wide policies and procedures, EXAMS policies, procedures, and guidance, and risk and control matrices to identify and test key control activities. We identified and reviewed control activities related to each of our sub-objectives, to include interviewing EXAMS personnel and testing related controls and processes in our broker-dealer examination sample testing. We also reviewed EXAMS' Compliance group's testing of controls activities,

³⁸ To establish our survey population, we obtained staffing reports from EXAMS and verified the information using SEC organizational charts, the SEC employee directory, and other information from TRENDS Cloud.

which supports the annual management assurance process. As Finding 2 describes, we determined that EXAMS lacked adequate internal procedures and guidance to establish certain examination information in TRENDS.

Information and Communication. EXAMS communicates with its workforce, including about policies and procedures related to the examination program and TRENDS Cloud, through its internal web site. The BDx program also has an internal site with examination modules, resources based on registrant type, national initiative information, recent developments, and FINRA reports, among other things. Furthermore, EXAMS externally communicates broker-dealer examination information in the SEC's annual performance plans and performance reports included with the SEC's annual congressional budget justifications. We interviewed EXAMS management and staff responsible for collecting and validating annual broker-dealer examination data for public reporting and validated the published broker-dealer examination data.

Monitoring. We reviewed EXAMS' internal control documentation and policies and procedures and discussed with EXAMS management its roles and responsibilities for monitoring broker-dealer examinations. We accessed examination systems and tools used to monitor and visualize examination results and met with EXAMS personnel responsible for such activities. We also obtained and reviewed routine monitoring reports and records of meetings and calls related to the oversight of broker-dealer examinations. As Finding 1 describes, we identified opportunities to improve monitoring and performance measurement related to broker-dealer examinations.

As noted in this report, we found that, overall, broker-dealer examinations generally complied with policies, procedures, and controls we tested. However, we identified areas for potential improvement related to internal controls and examination processes within the context of our objectives. Our recommendations, if implemented, should help strengthen EXAMS' broker-dealer examination program.

Data Reliability

GAO's *Assessing Data Reliability* (GAO-20-283G, December 2019) states reliability of data means that data are applicable for audit purpose and are sufficiently complete and accurate. Data primarily pertains to information that is entered, processed, or maintained in a data system and is generally organized in, or derived from, structured computer files. Furthermore, GAO-20-283G defines "applicability for audit purpose," "completeness," and "accuracy" as follows:

"Applicability for audit purpose" refers to whether the data, as collected, are valid measures of the underlying concepts being addressed in the audit's research objectives.

"Completeness" refers to the extent to which relevant data records and fields are present and sufficiently populated.

"Accuracy" refers to the extent that recorded data reflect the actual underlying information.

To address our objectives, we relied on computer-processed data from TRENDS Cloud. To assess the reliability of that data we:

- Interviewed knowledgeable personnel, including an EXAMS technology branch chief, TRENDS Cloud contractors, and Office of Risk and Strategy personnel involved in TRENDS Cloud reporting and visualization dashboards.
- Reviewed the data dictionary for TRENDS Cloud and system documentation and reports, including a system security plan, security categorization worksheet, privacy impact assessment, and system authorization to operate document for TRENDS Cloud, as well as other TRENDS Cloud operating guidance.
- Tested all approved broker-dealer examinations between FY 2020 and FY 2023 to determine whether there were duplicative entries or data was missing in key and required data fields.

We confirmed with EXAMS personnel the system identifiers for completed, approved broker-dealer examinations in TRENDS Cloud, which we used to select a sample for further testing. We also reviewed published broker-dealer examination totals and compared them to internal reports and visualizations. We identified minor discrepancies that we discussed with EXAMS management, who explained the variations.

Overall, we found the TRENDS Cloud data sufficiently reliable for the purpose of this evaluation.

Prior Coverage

Between 2016 and 2022, the SEC OIG and GAO issued the following reports of particular relevance to this evaluation:

SEC OIG:

- *Registered Investment Adviser Examinations: EXAMS Has Made Progress To Assess Risk and Optimize Limited Resources, But Could Further Improve Controls Over Some Processes* (Report No. 571, January 25, 2022).
- *Audit of the Office of Compliance Inspections and Examinations' Investment Adviser Examination Completion Process* (Report No. 541, July 21, 2017).
- *Office of Compliance Inspections and Examinations' Management of Investment Adviser Examination Coverage Goals* (Report No. 533, March 10, 2016).

GAO:

- *Securities Regulation: SEC Could Take Further Actions to Help Achieve Its FINRA Oversight Goals* (GAO-21-576SU, July 2021).
- *Securities Regulation: SEC Inspections of Financial Industry Regulatory Authority's Governance Were Consistent with Internal Guidance* (GAO-18-522, July 2018).

These reports can be accessed at <https://www.sec.gov/oig> (SEC OIG) and <https://www.gao.gov> (GAO).


Appendix II. Management Comments



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

MEMORANDUM

TO: Rebecca L. Sharek, Deputy Inspector General for Audits, Evaluations, and Special Projects, Office of Inspector General

FROM: Keith E. Cassidy, Acting Director, Division of Examinations 

RE: Management Response to draft Report *Enhanced Planning, Performance Measurement and Evaluation, and Information Can Improve Oversight of Broker-Dealer Examinations*

DATE: September 13, 2024

The Division of Examinations ("EXAMS" or the "Division") appreciates the benefit of the Office of Inspector General's ("OIG") evaluation of the Division's oversight of broker-dealers. We are pleased that the OIG audit concluded that the Division generally complied with its policies, procedures, and controls for performing and documenting broker-dealer examinations performed between FY 2020 and FY 2023.

We welcome and concur with the Report's recommendations for enhancing the effectiveness of our broker-dealer examination program, including by developing additional program metrics based on recognized leading practices, better documenting certain aspects of our risk-based exam planning process, and improving how staff record certain information in the examination recordkeeping system to promote more insightful management reporting. Our response to each of the OIG recommendations is described in greater detail in Appendix A.

Finally, EXAMS appreciates the OIG's recognition and encouragement of the actions that EXAMS' current leadership team has completed or commenced over the last two years to enhance the effectiveness of the broker-dealer examination program. As the Report acknowledges, EXAMS leadership is engaged in a holistic and strategic assessment of the examination program to improve its effectiveness. In May 2023, EXAMS selected a new National Associate Director to oversee the Broker-Dealer and Exchange ("BDX") program on a nationwide basis. EXAMS also created a new headquarters office Associate Director position and a new National Risk Strategist to further develop BDX's risk-based examination program. Additionally, EXAMS has been working to better align how the Division projects its future examination workload with its risk-based examination approach and available resources. As further acknowledged in the Report, EXAMS has established a team to evaluate and optimize examination program performance measures. EXAMS has also undertaken various other actions to improve examination recordkeeping, facilitate better management reporting, and promote improved data quality in the examination recordkeeping system used by staff.

Through these and other planned actions, EXAMS' leadership team is committed to evaluating and continuing to enhance our risk-based broker-dealer examination program to enable our talented and expert staff to promote strong and effective industry compliance practices this year, and in the years to come.

Appendix A: Management's Responses to OIG's Recommendations

The following are management's responses to each of the recommendations provided in the OIG report.

Recommendation 1: (a) Develop Broker-Dealer and Exchange examination program goals and objectives that reflect core mission areas; (b) establish Broker-Dealer and Exchange examination program performance metrics that align with established program goals and objectives and are based on recognized leading practices (that is, are outcome-based, informative, clear, and linked to agency goals and mission); and (c) develop Broker-Dealer and Exchange examination program evaluation and monitoring activities that consider performance metric data and are based on recognized leading practices (that is, activities that help drive potential change by determining whether the program is working and why).

Response: We concur. In addition to the actions taken by EXAMS recognized in the OIG report, EXAMS will develop BDX goals and objectives. EXAMS will establish BDX performance metrics that align with these goals and objectives and are based on recognized leading practices. EXAMS will also develop a plan for evaluation and monitoring activities that consider performance metric data and are based on recognized leading practices.

Recommendation 2: Conduct a comprehensive review of the following topics as part of ongoing efforts to improve the Broker-Dealer and Exchange examination program, and establish appropriate corresponding corrective action(s):

- a. Examination scoping practices holistically, to include the use of limited scope examinations (such as thematic initiatives).
- b. Alignment of examinations with annual priorities, industry activities, and risks identified in broker-dealer planning data.
- c. Extent of asset verification performed, and waivers authorized.
- d. Broker-dealer examination coverage of the Financial Industry Regulatory Authority and how it may be leveraged in program planning.

Response: We concur. In addition to the actions taken by EXAMS recognized in the Report, EXAMS will conduct a comprehensive review of the topics listed above to improve the BDX program and establish corresponding corrective action.

Recommendation 3: Require that exam plans or other planning memoranda contain more detailed information about the process used to select broker-dealer examination candidates and the reason(s) for selection to help support that risk-based strategies were used.

Response: We concur. EXAMS will update the Exam Manual's policies related to broker-dealer exam planning to generally require regional offices to memorialize in writing their risk-based process used to select examination candidates and the reason(s) for selection. In developing these policies, EXAMS will take into consideration variances among the regional offices in the size and staffing levels of their broker-dealer examination program in order to develop requirements that are appropriate based on each office's broker-dealer composition and examination workload.

Recommendation 4: Establish guidance to assist examiners entering examination setup information—to include priorities, initiatives, and examination types—in TRENDS.

Response: We concur. In addition to the actions taken by EXAMS recognized in the Report, EXAMS will establish guidance to assist examiners entering examination setup information – to include priorities, initiatives, and examination types – in TRENDS.

Recommendation 5: Finalize development of a process that will ensure timely approval and updates to TRENDS reference data related to priorities, thematic initiatives, and examination types.

Response: We concur. In addition to actions taken by EXAMS recognized in the Report, EXAMS will finalize a process to ensure timely approval and updates to TRENDS reference data related to program priorities, thematic initiatives, and examination types.

Recommendation 6: Review and update, as appropriate, procedures and guidance relevant to asset verification and risk ratings to ensure recordkeeping in TRENDS is consistent across broker-dealer examination files, which may include incorporating reviews of this information across broker-dealer examinations.

Response: We concur. In addition to actions taken by EXAMS recognized in the Report, EXAMS will review and update, as appropriate, the procedures and guidance relevant to the performance of asset verification and the identification of broker-dealer risk ratings to ensure recordkeeping in TRENDS is consistent across broker-dealer examination files.

Major Contributors to the Report

Colin Heffernan, Audit Manager

Danielle Grabowski, Auditor

John Gauthier, Auditor

Steve Encomienda, Auditor

Comments and Suggestions

If you wish to comment on the quality or usefulness of this report or suggest ideas for future audits, evaluations, or reviews, please send an e-mail to OIG Audit Planning at AUDplanning@sec.gov.

TO REPORT

fraud, waste, and abuse

Involving SEC programs, operations, employees,
or contractors

FILE A COMPLAINT ONLINE AT

www.sec.gov/oig



CALL THE 24/7 TOLL-FREE OIG HOTLINE

833-SEC-OIG1

