SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-91128]

February 12, 2021

Order Extending the Annual Reports Filing Deadline for Certain Smaller Broker-Dealers

I. Introduction

Broker-dealers registered with the U.S. Securities and Exchange Commission ("SEC" or "Commission") are generally required to file with the Commission, within 60 calendar days after the end of the fiscal year of the broker-dealer, a financial report and either a compliance report or exemption report, along with reports prepared by an independent public accountant[1] covering the financial report and, as applicable, the compliance or exemption report (collectively the "annual reports").[2] Pursuant to paragraph (m)(3) of Exchange Act Rule 17a-5 ("Rule 17a-5"), the Financial Industry Regulatory Authority, Inc. ("FINRA") has requested that the Commission extend by 30 calendar days the deadline for certain smaller broker-dealers to file the annual reports.[3] This order grants such an extension to certain smaller broker-dealers, subject to the conditions described in section III below.

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1 The independent public accountant must be qualified and independent in accordance with Rule 2-01 of Regulation S-X and must be registered with the Public Company Accounting Oversight Board ("PCAOB") if required by the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley Act"). *See* Pub. L. No. 107-204, 116 Stat. 745 (2002); 17 CFR 240.17a-5(f)(1).

2 *See* 17 CFR 240.17a-5(d)(5).

3 *See* 17 CFR 240.17a-5(m)(3) (stating that on written request of any national securities exchange, registered national securities association, broker-dealer, or on its own motion, the Commission may grant an extension of time or an exemption from any of the requirements of Rule 17a-5 either unconditionally or on specified terms and conditions).

II. Discussion

A. FINRA's Request

In a letter dated February 11, 2021, FINRA requested that the Commission issue an order pursuant to paragraph (m)(3) of Rule 17a-5 to extend by 30 calendar days the deadline for certain smaller broker-dealers to file their annual reports.[4] In FINRA's request, it indicated that it had been informed by smaller broker-dealers and auditors that permitting an additional 30 days for filing of the annual reports may help to reduce the burdens in obtaining audit services by providing an expanded time frame for the completion of such audits thereby easing the availability of auditors.[5] FINRA stated in the letter that the fiscal year for most broker-dealers ends on the last calendar day of the year (December 31), which results in the greatest demand for audit services in the 60 calendar days following that date. Further, much of the work required to complete these audits is performed after the broker-dealer files the final FOCUS Report (Form X-17A-5 Part II or IIA) for the audit year, which is due to be filed with the Commission 17 business days after the end of the prior month (*i.e.*, January 27 for broker-dealers with December 31 fiscal year ends). As a result, the required audit work is conducted within a compressed period when audit services are in greatest demand and the availability of independent public accountants and other third-party professionals may be limited.

FINRA further identified a number of factors that compound the burden of smaller broker-dealers in preparing the annual reports and undergoing an audit of them. For example, the auditors of smaller broker-dealers typically do not perform interim audit work prior to the fiscal year end. Interim audit work typically includes the auditors testing items such as revenue,

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4 *See* Letter from Kris Dailey, Vice President, Office of Financial and Operational Risk Policy, FINRA to Michael A. Macchiaroli, Associate Director, SEC (February 11, 2021).

5 *See id*. at 2.

expenses, and internal controls. In addition, some smaller broker-dealers utilize outside professional and consulting services to assist them in preparing supporting materials for the audit and to respond to auditor requests. These outside professional and consulting service providers often have multiple smaller broker-dealer clients with the same fiscal year end. As a result, the service providers' may have a limited capacity during the audit period to provide their services to smaller broker-dealers. Furthermore, because many smaller broker-dealers do not have fully automated financial and operational recordkeeping and reporting infrastructures, they must rely on manual processes to prepare documents for the independent public accountant to audit or review, which can take additional time as compared to more automated processes.

FINRA also stated that some audit firms have chosen to forego registration with the PCAOB, resulting in fewer independent public accountants qualified under Rule 17a-5 to perform broker-dealer audits.[6] FINRA indicates that the additional 30 days to complete a smaller broker-dealer audit may alleviate capacity issues for PCAOB-registered auditors. FINRA stated that it has been informed by broker-dealers and auditors that the additional 30 days would help the limited number of PCAOB-registered auditors to perform the work necessary to complete reports covering them. FINRA stated the additional time could promote better quality of the annual reports.

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[6] In its 2012 Annual Report on the Interim Inspection Program Related to the Audits of Brokers and Dealers ("Annual Inspection Report"), the PCAOB reported that there were 783 registered public accounting firms. In the 2019 Annual Inspection Report, that figure had declined to 411. *See* PCAOB, Information for Auditors of Broker-Dealers, *available at* https://pcaobus.org/Pages/BrokerDealers.aspx.

B. FINRA's Proposed Conditions for the Requested Relief

FINRA proposed that the extension of 30 calendar days be made available only to broker-dealers that meet certain conditions. The first condition is that the broker-dealer must be in compliance with Exchange Act Rule 15c3-1[7] ("Rule 15c3-1") as of the date of its most recent fiscal year end. FINRA believes this condition is appropriate because the financial condition of a member that avails itself of the additional 30 days should not be such as to raise concerns about whether the member may continue to conduct its broker-dealer activities. The second condition is that as of the date of the broker-dealer's most recent fiscal year-end, the broker-dealer must have had total capital and allowable subordinated liabilities of less than $50 million, as reported in box 3530 of Part II or IIA of its FOCUS Report. FINRA believes this condition is appropriate because it helps to target the contemplated extension to the smaller firms that are in need of such relief. The third condition is that the extension be made available only to those broker-dealers eligible to file an exemption report as part of its most recent fiscal year end annual reports.[8] FINRA believes this condition is appropriate so as to ensure that the extension is only available

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[7] *See* 17 CFR 240.15c3-1.

[8] *See* 17 CFR 240.17a-5(d)(1)(i)(B) (prescribing whether a broker-dealer must file the compliance report or the exemption report). A broker-dealer must file an exemption report if the firm claimed it was exempt from Rule 15c3-3 (17 CFR 240.15c3-3) throughout the most recent fiscal year and was not subject to paragraph (p) of Rule 15c3-3 (which addresses segregation requirements with respect to security-based swaps). Otherwise, the broker-dealer must file the compliance report. *See also Broker-Dealer Reports*, Exchange Act Release No. 70073 (July 30, 2013), 78 FR 51910, 51915 (Aug. 21, 2013) n. 74 (stating that a broker-dealer should file an exemption report if it has not held customer securities or funds during the fiscal year even if it does not fit into one of the exemption provisions of Rule 15c3-3 identified on the FOCUS Report).

See also Frequently Asked Questions Concerning the July 30, 2013 Amendments to the Broker-Dealer Financial Reporting Rule (updated July 1, 2020) (describing the Division and Trading and Markets staff's views regarding the eligibility of certain broker-dealers to file exemption reports in accordance with the circumstances described in footnote 74 of the 2013 *Broker-Dealer Reports* release, among other things). Staff statements, including Frequently Asked Questions, represent the views of the staff. They are not rules, regulations, or statements of the Commission. The Commission has neither approved nor disapproved their content. These staff statements, like all staff guidance, have no legal force or effect: they do not alter or amend applicable law, and they create no new or additional obligations for any person.

to firms that, by virtue of their business activities, generally pose less risk to customers because they do not custody funds and securities. The fourth condition is that the broker-dealer submits written notification to FINRA of its intent to avail itself of the additional 30 calendar days for filing its annual reports on an ongoing basis for as long as it meets these conditions. FINRA believes that the notification is appropriate so as to enable FINRA to monitor effectively firms that avail themselves of the additional 30 days. The final condition is that the broker-dealer submits the annual reports electronically to the Commission using an appropriate process. FINRA believes this condition is appropriate because it permits greater efficiency and is consistent with SEC staff guidance.

C. Commission Analysis

According to FINRA, a smaller broker-dealer's window of time to prepare the annual reports and undergo an audit by an independent public accountant is often particularly compressed because much of the audit work does not commence until after the broker-dealer files its fiscal year-end FOCUS Report. According to FINRA, audit work for small broker-dealers is performed predominantly during the period of time between the due date for the fiscal year-end FOCUS Report (17 business days after the firm's fiscal year end) and the annual reports filing due date (60 calendar days after the fiscal year end). Further, according to FINRA, the auditors of smaller broker-dealers do not typically perform interim audit work prior to the broker-dealer's fiscal year end, unlike most larger broker-dealers. The lack of this interim audit work, which typically includes the testing of items such as revenue, expenses, and internal controls, compresses the time auditors have to perform required procedures in advance of the filing deadline. This also restricts the time frame for smaller broker-dealers and their auditors to identify and resolve issues.

Moreover, according to FINRA, many smaller broker-dealers use manual processes to prepare supporting documentation for the audit or review and respond to auditor inquiries, rather than the more automated processes typically used by larger broker-dealers. This can make the work necessary to prepare the annual reports and audit them more labor intensive and time consuming. In addition, according to FINRA, some smaller broker-dealers retain third-party professionals to assist them with their financial reporting. These professionals often provide services to multiple smaller broker-dealers with the same fiscal year end, resulting in these professionals having limited capacity during the relatively brief period between the FOCUS Report filing due date and the annual reports filing due date. These professionals' limited capacity can further compress the timeframe for performing the work necessary to prepare the annual reports.

Paragraph (m)(3) of Rule 17a-5 provides that the Commission may grant an extension of time for broker-dealers to file their annual reports. After considering the points raised in FINRA's letter and the burdens faced by smaller broker-dealers in preparing and filing the annual reports, the Commission believes that it would be appropriate to extend the deadline for certain smaller broker-dealers to file their annual reports by 30 calendar days.[9] This additional time should expand the timeframe (from slightly more than one month) between the deadline for submitting the fiscal year-end FOCUS Report and the deadline to file the annual reports (*i.e.*, the timeframe in which much of the work is performed to prepare the annual reports). To the extent auditors are able to better focus on the audit and review of annual reports for the small broker-

[9] FINRA requested relief on behalf of its member broker-dealers. This Order extends relief to all broker-dealers satisfying its conditions in order to treat similarly situated broker-dealers equally regardless of whether they are FINRA members.

dealer clients who avail themselves of the extension, this relief could help promote quality financial reporting.

The Commission further believes it is appropriate to limit this relief to broker-dealers meeting the conditions described in FINRA's request, which should also maintain investor protections. Conditioning the extension on the broker-dealer being in compliance with the net capital requirements of Rule 15c3-1 as of the date of its fiscal year end is appropriate because a broker-dealer that is not in compliance with the rule poses a heightened risk to its customers and other securities market participants because of its financial condition. Excluding a net capital-deficient broker-dealer from this relief will assist the Commission and the broker-dealer's designated examining authority to monitor the financial condition of the firm on a timely basis, including analyzing whether the firm will be able to continue as a going concern. Therefore, a broker-dealer with a net capital deficiency will not be able to avail itself of the additional 30 days provided for in this Order.

The Commission also believes it is appropriate to limit the availability of the extension to smaller broker-dealers. As discussed above, the extension could alleviate unique burdens associated with the compressed timeframe for smaller broker-dealers to prepare their annual reports and their independent public accountants to perform the audit work necessary to prepare reports covering them. Moreover, broker-dealers that conduct a substantial securities business and thus are in a position to potentially pose significant risk to investors and to the fair, orderly, and efficient functioning of the markets, will not be eligible for the extension. Therefore, the Commission is limiting the relief to broker-dealers that have total capital and allowable subordinated liabilities of less than $50 million, as requested by FINRA. Broker-dealers falling below the $50 million threshold constitute approximately 3% of the total capital of all broker-

dealers. The Commission believes that the $50 million threshold is appropriate in this context because smaller broker-dealers pose less significant risks to the fair, orderly, and efficient functioning of the markets.

Broker-dealers that maintain custody of customer securities and cash are not eligible to file exemption reports and are generally larger in size than broker-dealers that do not carry customer accounts. The Commission believes firms that file an exemption report—because of their relative size and the fact that they do not hold customer funds or securities, or owe money or securities to customers and do not carry customer accounts, or are exempt from Rule 15c3-3 pursuant to paragraph (k)(2) of that rule—present less risk to customers. Therefore, a broker-dealer must be permitted to file an exemption report as part of the annual reports to qualify for the relief. Based upon information included in broker-dealers' FOCUS Reports, the Commission believes that approximately 3,000 of the 3,620 broker-dealers registered with the Commission would meet the $50 million threshold and exemption report filing conditions.

The Commission believes that it is appropriate to make the 30-day extension available only to broker-dealers that have provided written notice to their designated examining authority of their intent to avail themselves of the extension. The designated examining authority is responsible for oversight of broker-dealers' adherence to the financial responsibility rules, including Rule 17a-5. This requirement will allow the broker-dealer's designated examining authority to more effectively monitor firms by enabling it to distinguish between broker-dealers that are filing their annual reports late as opposed to firms availing themselves of the relief in this Order.

Finally, the Commission believes it is appropriate to limit the availability of the relief in this order to broker-dealers that file the annual reports electronically with the Commission using

an appropriate process.[10] The electronic filing condition promotes efficiency by ensuring broker-dealers that rely on the 30-day extension will have their annual reports made available to Commission staff and to the public more quickly than if they had been filed in paper within the deadline provided in Rule 17a-5. Paper filings must be manually processed, which is time consuming and delays the availability of annual reports to the staff of the Commission and to the public. By comparison, annual reports that are filed electronically need minimal or no manual processing. Therefore, to help ensure the annual reports are made promptly available, the Commission is conditioning the relief on electronic filing.

III. Conclusion

IT IS HEREBY ORDERED pursuant to section 17(a)(1) of the Exchange Act and paragraph (m)(3) of Rule 17a-5 thereunder that the deadline in paragraph (d)(5) of Rule 17a-5 for filing the annual reports is extended by 30 calendar days, provided that the broker-dealer:

(1) As of its most recent fiscal year end:

a. Was in compliance with Rule 15c3-1; and

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[10] The Commission notes that the staff of the Division of Trading and Markets has previously issued no-action positions related to the electronic filing of broker-dealer annual reports. *See* Letter to Kris Daily, Vice President, FINRA from Michael A. Macchiaroli, Associate Director, Commission, dated January 27, 2017. Available at https://www.sec.gov/divisions/marketreg/mr-noaction/2017/finra-012717-electronic-filing-annual-reports.pdf. For further instructions relating to filing broker-dealer annual reports through EDGAR, *see Electronic Filing of Broker-Dealer Annual Reports*. Available at https://www.sec.gov/divisions/marketreg/electronic-filing-broker-dealer-annual-reports.htm.

See also Updated Division of Trading and Markets Staff Statement Regarding Requirements for Certain Paper Submissions in Light of COVID-19 Concerns. Available at https://www.sec.gov/tm/paper-submission-requirements-covid-19-updates-061820.

Staff statements represent the views of the staff. They are not rules, regulations, or statements of the Commission. The Commission has neither approved nor disapproved their content. These staff statements, like all staff guidance, have no legal force or effect: they do not alter or amend applicable law, and they create no new or additional obligations for any person.

b. Had total capital and allowable subordinated liabilities of less than $50 million, as reported in box 3530 of Part II or Part IIA of its FOCUS Report;

(2) Is permitted to file an exemption report as part of its most recent fiscal year end annual reports;

(3) Submits written notification to its designated examining authority of its intent to rely on this order on an ongoing basis for as long as it meets the conditions of the order; and

(4) Files the annual report electronically with the Commission using an appropriate process.

By the Commission.

Jill M. Peterson
Assistant Secretary