# 2020 FINRA Annual Financial Report

# Contents



**Robert W. Cook** | President and Chief Executive Officer

# A MESSAGE FROM THE PRESIDENT AND CEO

2020 was a unique year for FINRA and our member firms. The COVID-19 pandemic impacted—and continues to impact—how FINRA performs many of its functions, as well as the business and operations of our member firms. Throughout 2020, FINRA adapted our operations to ensure we continued to meet our mandate—supervising our member firms, overseeing securities markets and enforcing the rules and regulations of FINRA and the U.S. Securities and Exchange Commission (SEC) applicable to our members.

This 2020 Annual Financial Report—presented in accordance with U.S. generally accepted accounting principles (U.S. GAAP)—and FINRA's previously published 2020 Annual Budget Summary describe how FINRA managed its finances in 2020 to support its mission of protecting investors and promoting market integrity in a manner that facilitates vibrant capital markets.

As a not-for-profit, self-regulatory organization (SRO) whose operations are funded by industry fees, FINRA is guided by a set of Financial Guiding Principles that FINRA's Board reviews and approves each year. FINRA first published the Principles in 2018 to underscore our commitment to financial transparency.

## Financial Operations in 2020

As described in the 2020 Annual Financial Report, FINRA reported net income of $19.8 million in 2020 versus a net loss of $45.9 million in 2019, an increase of $65.7 million year over year. Our 2020 net income was driven by operating income of $30.9 million, offset by other expenses, net of investment gains, of $11.1 million. Higher operating income for the year reflected increased revenues, due primarily to higher trading volumes and a large number of public offerings, partially offset by an increase in operating expenses and lower interest and dividend income. The key drivers of our 2020 financial performance are discussed more fully in the Annual Financial Report.

FINRA's balance sheet remains strong. FINRA had $1.5 billion in equity as of December 2020 and 2019.

## Use of Fine Monies in 2020

In May, FINRA published a Report on Use of 2020 Fine Monies, describing the Board-approved projects that were supported by 2020 fine monies. In accordance with our Financial Guiding Principles, FINRA only uses fine monies for specific purposes—such as capital initiatives that enable improved oversight of and compliance by member firms—and only with the approval of the FINRA Board of Governors or its Finance, Operations and Technology Committee.

## 2021 Budget

Looking ahead, FINRA's 2021 annual budget reflects the expectation that many of the adjustments we made to our operations during 2020—and the related financial implications we experienced during this time—will continue well into 2021. The 2021 budget also demonstrates FINRA's commitment to investing in technology upgrades and other transformational initiatives that improve the efficiency and effectiveness of our operations, as well as enhance our longer-term financial sustainability.

FINRA remains focused on prudently managing our resources in the years to come. As we describe in the 2021 Annual Budget Summary, FINRA does not plan to raise fees in 2021, the eighth consecutive year we have not increased fees. Our financial plans for future years—which include continuing to strategically draw down on excess reserves in order to support FINRA's operations, while phasing in a delayed fee increase over several years—have been discussed extensively in previous financial reports, a 2020 regulatory filing with the SEC, and a communication to member firms last year.

FINRA remains committed to ensuring we are adequately prepared to meet the challenges ahead and fulfill our mission of investor protection and market integrity.

**Robert W. Cook**
President and Chief Executive Officer

# FINRA plays an essential role in the oversight of U.S. broker-dealers.

We promote market integrity in a manner that supports the important role our capital markets play in the U.S. financial systems.

**Our technology looks across markets to detect potential fraud.**

**79.7 billion**

market events processed on average every day in 2020

**Coordinating closely with the SEC and other federal and state regulators is an important part of our regulatory work.**

**970 fraud**

and insider trading cases referred to the SEC and other federal or state law enforcement agencies for prosecution

## We enforce compliance with investor protection rules.

**5,623**
exams and reviews conducted in 2020

**$57**
million in fines

**$25.2**
million in restitution to harmed investors

**2**
firms expelled

**375**
brokers suspended

**246**
brokers barred

## We work to keep investors informed.

### FINRA Investor Education Foundation

Committed $120.0 million for financial capability and fraud prevention initiatives since inception.

### Securities Helpline for Seniors

FINRA launched the Helpline on April 20, 2015, to assist senior and vulnerable investors with questions or concerns about their brokerage accounts and investments. As of December 31, 2020, the Helpline has:

- received more than 21,000 calls from all 50 states and several countries;
- made more than 1,600 referrals to state, federal and international regulators; and
- assisted with the return of more than $7.7 million to investors.

# Management Report on Operations

## Who We Are

The Financial Industry Regulatory Authority, Inc.® (FINRA®) is a not-for-profit self-regulatory organization (SRO) authorized by federal law to help protect investors and ensure the fair and honest operation of securities markets. Under the oversight of the U.S. Securities and Exchange Commission (SEC), we regulate the activities of U.S. broker-dealers and perform market regulation pursuant to our own statutory responsibility and under contract for certain exchanges.

## Our Mission

Our core mission is to provide investor protection and promote market integrity through comprehensive and effective regulation of the broker-dealer industry.

## Our Regulatory Model

To carry out its mission, FINRA uses a multi-pronged approach that includes regulation, rulemaking, transparency and education:

**Member Supervision**—monitors and examines for member compliance with securities laws and rules, and works to detect and address fraud or other misconduct.

**Market Regulation**—conducts automated surveillance, examinations and investigations of trading activity in U.S. equities, options and fixed income markets.

**Enforcement**—investigates possible misconduct and brings disciplinary actions for violations of securities rules and regulations.

**Rulemaking and Guidance**—adopts and interprets rules applicable to securities firms and brokers. FINRA solicits comment on its proposed rules from its member firms, investors and other interested parties. FINRA rules are approved by the SEC.

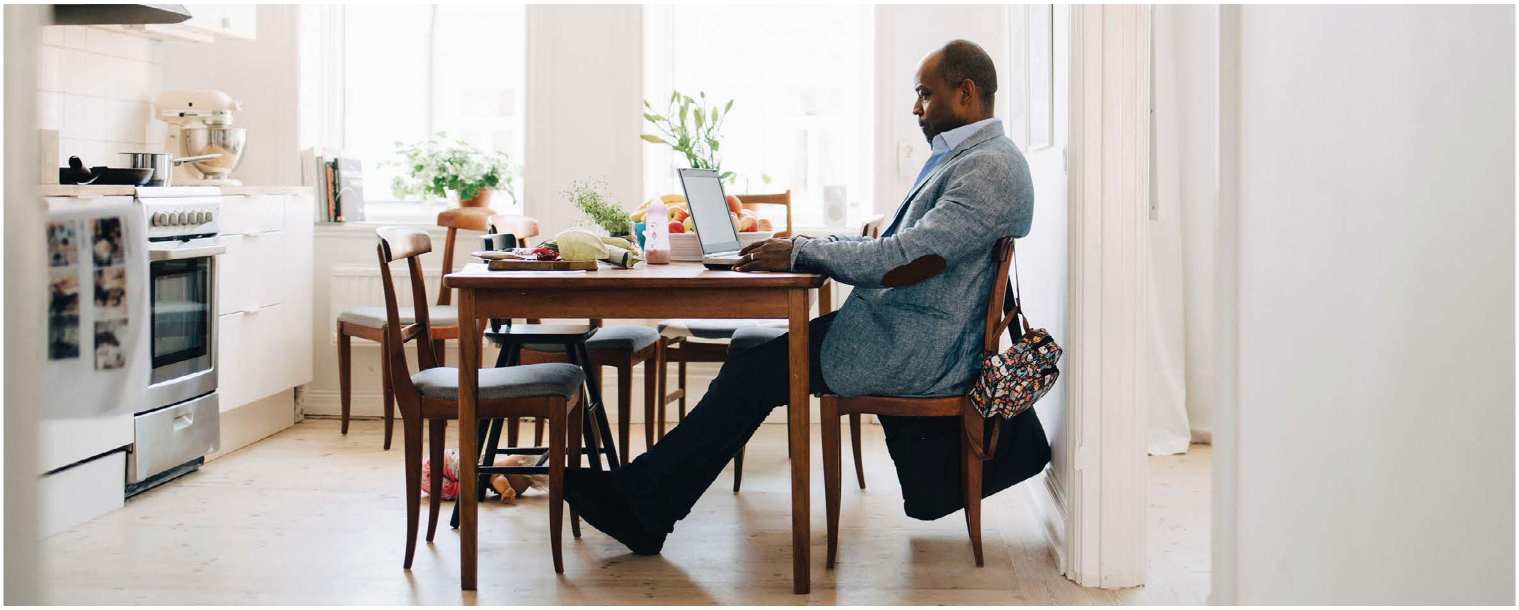
**Credentialing, Registration, Education and Disclosure**—operates FINRA's utilities to register and test securities industry personnel and provides those same services under contract for the benefit of investment advisers and mortgage brokers.

**Transparency Services**—operates facilities that disseminate real-time and historical market information for over-the-counter (OTC) trading in the equity and fixed income markets including the Trade Reporting and Compliance Engine® (TRACE®), and maintains the databases FINRA uses to oversee OTC securities.

**Dispute Resolution Services**—operates a dispute resolution forum for investors, brokerage firms and their registered employees, and administers arbitrations and mediations.

**Advertising Regulation**—oversees member firm communications to the public to ensure that they are fair, balanced and not misleading.

**Corporate Financing**—oversees corporate offerings to address fraudulent private placements and ensure underwriting compensation is fair.



**Disciplinary Adjudications**—adjudicates disciplinary cases brought by FINRA against FINRA members and appeals from adjudications.

**Member Relations**—maintains dialogue and education with FINRA member firms.

**Investor Education**—provides investors with financial tools and resources; and through the FINRA Investor Education Foundation® (the Foundation), supports important research and financial education initiatives.

**Office of the Chief Economist**—conducts research and analysis in support of FINRA's rulemaking and policy agendas.

FINRA's Board of Governors (Board) and its committees meet multiple times throughout the year to review the operations, risks and challenges associated with the furtherance of FINRA's mission. These committees include the Audit Committee; Regulatory Policy Committee; Regulatory Oversight Committee; Finance, Operations and Technology Committee (Finance Committee); Management Compensation Committee; and Executive Committee.

Pursuant to a contract with Consolidated Audit Trail, LLC, FINRA CAT, LLC (FINRA CAT), a wholly-owned subsidiary of FINRA, serves as the Plan Processor for the Consolidated Audit Trail (CAT). As the CAT Plan Processor, FINRA CAT operates and maintains certain aspects of CAT and continues to build and implement other aspects of CAT. Once fully built, CAT will be a central repository of reports of trades, quotes and orders for all U.S. exchange-listed and over-the-counter equity securities and U.S. exchange-listed options contracts across all U.S. markets and trading venues.

Further description of FINRA's statutory responsibilities, as well as its responsibilities under contract for certain exchanges, can be found in Note 1, "Organization and Nature of Operations," to the consolidated financial statements.

This Management Report should be read in connection with the consolidated financial statements and accompanying notes included elsewhere in this Annual Financial Report. The 2020 consolidated financial statements reflect the activities of FINRA and its consolidated subsidiaries, collectively referred to as "we," "our," "us," "FINRA" or the "Company" throughout this Management Report. As of and for the years ended December 31, 2020 and 2019, FINRA's primary consolidated subsidiaries were FINRA Regulation, Inc., FINRA CAT and the Foundation.

Our consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles (U.S. GAAP). Under U.S. GAAP, we are required to adopt accounting principles and make estimates and judgments to develop amounts reported in the consolidated financial statements and accompanying notes.

We describe our significant accounting policies in Note 2, "Summary of Significant Accounting Policies," Note 3, "Revenue from Contracts with Customers," Note 5, "Fair Value Measurement," and Note 7, "Employee Benefit Liabilities," to the consolidated financial statements.

## Our People

### We are one FINRA—working closely together to protect investors

FINRA employs a diverse team of staff who play an essential role in the oversight of U.S. broker-dealers and enable FINRA to effectively carry out our mission of investor protection and market integrity. As of December 31, 2020, our human capital consisted of approximately 3,600 employees whose diversity—backgrounds, education, cultures, thinking styles and unique perspectives—enables FINRA to remain an innovative regulator and respond appropriately to the dynamic broker-dealer industry we oversee.

FINRA hired more than 550 new employees in 2020 due to regular attrition and the one-time Voluntary Retirement Program (VRP) implemented in September 2019. In addition, more than 18 percent of FINRA's regular employees were promoted or hired into internal positions, compared to 16 percent in 2019. In 2020, the average tenure of FINRA employees decreased slightly to eight years compared to nine years in 2019.

### We work in communities across the country

With 19 offices and employees deployed across the United States, we operate in the communities where firms do business, better enabling us to understand emerging issues affecting investors right in their own neighborhoods.

At FINRA, we believe it is our responsibility to be good corporate citizens by enriching the communities where we live and work. FINRA's annual companywide volunteer service period, also known as the Month of Service, is one of the many ways FINRA is committed to being a socially responsible organization. In 2020, FINRA employees volunteered 5,460 hours with a variety of organizations.

### We are committed to fostering an inclusive and diverse workplace

Our goal is to ensure that every employee has the opportunity to thrive and contribute their unique talents to our organization. We are focused on building a workforce that mirrors the diversity of our communities and supports our mission of investor protection and market integrity.

Guided by FINRA's Diversity Leadership Council (DLC)—established in 2009 to develop and implement FINRA's diversity and inclusion strategy—FINRA has built a core program that centers on diversity awareness training and education, formal mentoring programs and a network of employee resource groups (ERGs). In 2020, FINRA's ERGs had an overall participation rate of 46 pecent and offered more than 100 events for employees.

# Diversity of Our Workforce

## Employees

- ▷ Male **57%** / Female **43%**
- ▷ White **62%** / Minority[1] **38%**

## Officers

- ▷ Female **37%**
- ▷ Minority **12%**

## Board

- ▷ Female **50%**
- ▷ Minority **18%**

## Our employees represent...

- ▷ Protected Veterans[2,3] **1.3%**
- ▷ Differently Abled[3] **9.9%**

## ... plus four distinct generations

- ▷ Baby Boomers (1946 – 1964) **15%**
- ▷ Generation X (1965 – 1980) **48%**
- ▷ Generation Y / Millennials (1981 – 1996) **36%**
- ▷ Generation Z (1997 and onwards) **1%**

In June 2020, FINRA's Board of Governors issued a statement affirming their commitment to "the principle of equal justice under the law and to fight all forms of racism and prejudice." In July 2020, and in line with the goals proposed by the Board, FINRA formed a Racial Justice Task Force to identify steps FINRA can take, consistent with our mission, to advance racial justice, continue to foster greater inclusiveness and eliminate prejudice within our organization, our communities and the securities industry.

For more about FINRA's diversity and inclusion program, please see our 2020 Diversity and Inclusion Year in Review.

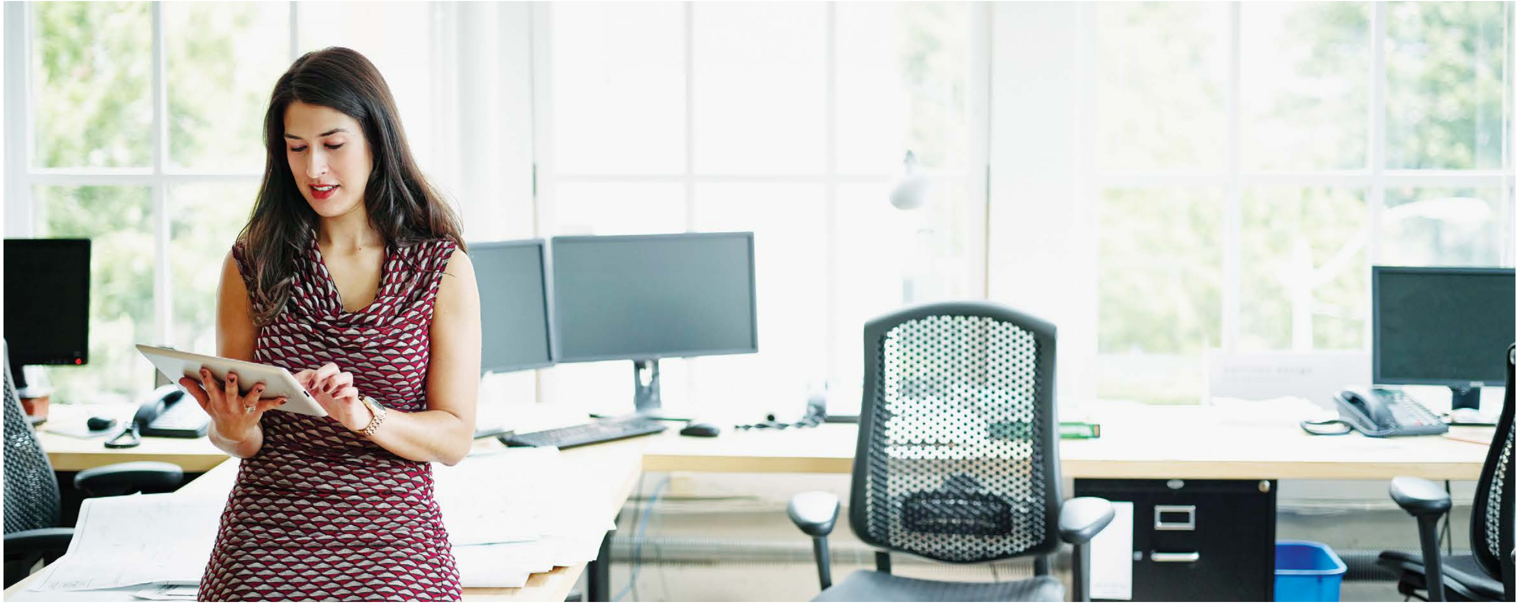
### We are one team with one mission

FINRA's values—collaboration, expertise, innovation, and responsibility—reflect not only who we are as an organization, but what we strive for: one team, acting with one vision to achieve our public-service mission. Our culture is fostered by how each of us brings FINRA's values to life—through how we make decisions and how we operate to serve our mission.

1 **Minority** refers to the percentage of employees who selected a racial category other than "White (Not Hispanic or Latino)" in response to the EEO-1 Voluntary Self Identification Form to include American Indian or Alaska Native (Not Hispanic or Latino); Black or African American (Not Hispanic or Latino); Hispanic or Latino; Native Hawaiian or Other Pacific Islander (Not Hispanic or Latino); Two or More Races (Not Hispanic or Latino).

2 **Protected Veterans** refers to the percentage of employees who have voluntarily indicated that they identify as a veteran as defined by the Vietnam Era Veterans' Readjustment Assistance Act of 1974 (VEVRAA), as amended by the Jobs for Veterans Act of 2002.

3 **Source:** FINRA 2020 Employee Disability and Veteran Self-Identification Form.



## RESULTS OF OPERATIONS

### Summary of Operations

The following table provides a summary of our financial results on a U.S. GAAP basis for the two years ended December 31, 2020.

| | Years Ended December 31, 2020 | 2019 |
|---|---|---|
| | *(in millions)* | |
| Operating revenues | $ 1,105.6 | $ 899.0 |
| Fines | 57.0 | 39.5 |
| Net revenues | 1,162.6 | 938.5 |
| Expenses | (1,155.1) | (1,095.0) |
| Interest and dividend income | 23.4 | 32.9 |
| Operating income loss | 30.9 | (123.6) |
| Net realized and unrealized investment gains | 3.9 | 90.9 |
| Other expense | (15.0) | (13.2) |
| Net income (loss) | $ 19.8 | $ (45.9) |

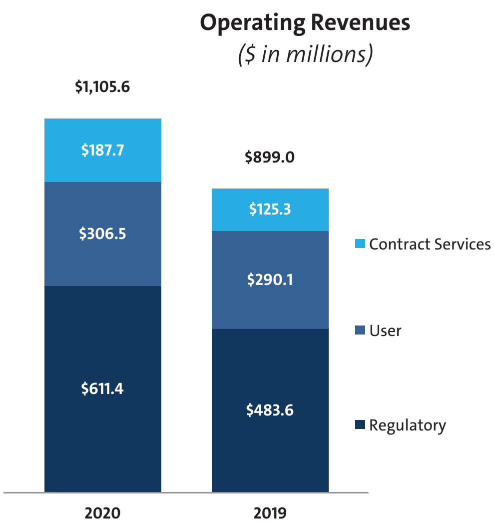
We reported net income of $19.8 million in 2020 versus a net loss of $45.9 million in 2019, an increase of $65.7 million year over year. Our 2020 net income of $19.8 million was driven by operating income of $30.9 million and investment gains of $3.9 million, offset by other expenses of $15 million. An increase in revenues, partially offset by an increase in operating expenses and lower interest and dividend income, resulted in operating income in 2020.

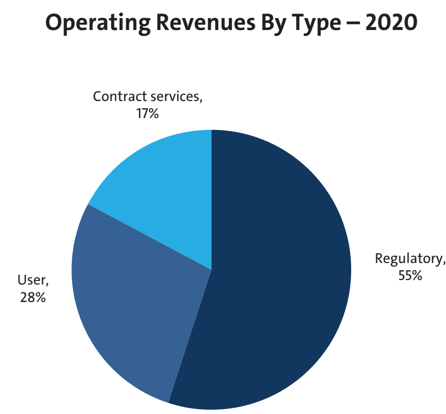
On September 18, 2019, FINRA announced the implementation of a one-time VRP. The VRP was designed for those employees who were retirement-eligible (minimum age of 55) and when combined with years of service, reached a minimum combined age/years of service of 65 as of December 31, 2019. The VRP included provisions for benefits in the form of severance payments; medical, dental and vision benefits; outplacement services; and eligibility and payout for various bonus programs, as applicable. We followed the accounting guidance related to pension plan special termination benefits and severance benefits provided under the VRP.

A more detailed look at our operating results follows.

# Management Report on Operations (continued)

**OPERATING REVENUES**




**COMMENTARY: 2020 – 2019**

Regulatory revenues, such as the Gross Income Assessment (GIA), Personnel Assessment (PA), Branch Office Assessment and Trading Activity Fees (TAF), consistently represent approximately half of FINRA's operating revenues on an annual basis. User revenues (dispute resolution, transparency services, registrations, qualification examinations, FINRA-sponsored educational programs and conferences, and reviews of advertisements, corporate filings and disclosures) consistently represent between one-quarter and one-third of FINRA's operating revenues on an annual basis.

FINRA's operating revenues for 2020 increased $206.6 million or 23 percent. The following table identifies the changes in operating revenues year over year.

**Operating Revenues**
*(in millions)*

| 2020 – 2019 | |
|---|---|
| **2019** | **$ 899.0** |
| Regulatory revenues | 127.8 |
| Contract services revenues | 62.4 |
| User revenues | 16.4 |
| **2020** | **$1,105.6** |

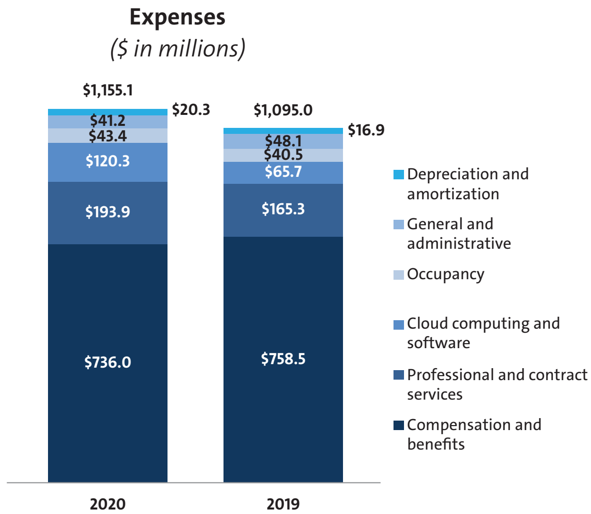
Regulatory revenues. Over 90 percent of the increase in regulatory revenues was attributable to higher TAF. Volume increases due to market volatility during the COVID-19 pandemic drove the increase in TAF. The remainder of the increase was driven by higher GIA, due to an increase in industry revenues.

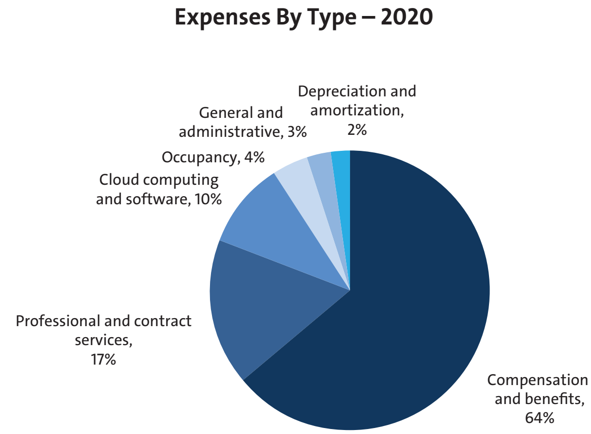
Contract services revenues. An increase in revenues related to our role as the CAT Plan Processor and increased transition service levels related to the mortgage licensing system FINRA developed and deployed to the State Regulatory Registry LLC (SRR) primarily drove the increase in contract services revenues, partially offset by reduced fees from changes to the scope of regulatory functions provided under our regulatory services agreements with U.S. securities exchanges.

User revenues. An increase in the number of initial and secondary public offerings year over year primarily drove the increase in user revenues, partially offset by declines in qualification examination enrollment and the number of arbitration hearing sessions held as a result of the COVID-19 pandemic.

# Management Report on Operations (continued)

## EXPENSES




## COMMENTARY: 2020 – 2019

FINRA is largely a service organization. Our expenses are driven by employee-related costs, as we seek to attract, develop and retain a diverse group of talented staff, particularly in the highly specialized areas of regulation and technology, to enable FINRA to carry out its regulatory mandate in today's ever-changing markets. Employee compensation and benefits are FINRA's largest expense, consistently representing approximately two-thirds of total expenses on an annual basis. Information regarding FINRA's compensation philosophy can be found in the accompanying Management Compensation Committee Report of this 2020 Annual Financial Report. FINRA had approximately 3,600 employees as of December 31, 2020, and approximately 3,400 employees as of December 31, 2019. Staff increases related to our regulation and technology functions drove the year-over-year increase in employees.

Expenses for 2020 increased $60.1 million or 5.5 percent. The following table identifies the changes in expenses year over year.

**Expenses**
*(in millions)*

| 2020 – 2019 | |
|---|---|
| **2019** | **$1,095.0** |
| Cloud computing and software | 54.6 |
| Professional and contract services | 28.6 |
| General and administrative | (6.9) |
| Compensation and benefits | (22.5) |
| All other | 6.3 |
| **2020** | **$1,155.1** |

Cloud computing and software. Our expanded use of cloud computing services under our enterprise customer agreement with a third-party vendor, primarily related to our role as the CAT Plan Processor, combined with an increase in computer software subscriptions drove the increase in cloud computing and software expenses.

Professional and contract services. Increased consulting and technology development, enhancement and maintenance costs, primarily related to our role as the CAT Plan Processor, were the primary driver of the increase in professional and contract services expenses.

General and administrative. Reduced travel-related costs due to the COVID-19 pandemic drove the decrease in general and administrative expenses.

Compensation and benefits. Lower self-funded employee insurance expenses ($13.9 million) due to the COVID-19 pandemic, lower incentive compensation ($14.4 million) and VRP severance expense ($33.6 million) recorded in 2019, but not in 2020, primarily account for the decrease in compensation and benefits expenses, partially offset by annual employee merit increases and an increase in the number of employees during the year ($26.2 million in additional salary expense), and higher vacation balances ($9.2 million) due to the COVID-19 pandemic.

**INVESTMENT RETURNS**

Traditionally, FINRA has relied on its reserve portfolio to fund operating expenditures in excess of its annual revenues in any given year. FINRA's reserve portfolio provided a 1.2 percent return in 2020 compared to a 6 percent return in 2019.

Additional information regarding the reserve portfolio, strategy and returns can be found in the accompanying Investment Committee Report of this 2020 Annual Financial Report. Descriptions of the nature of and accounting for FINRA's investments are described in Note 2, "Summary of Significant Accounting Policies," and Note 4, "Investments," to the consolidated financial statements.

**RESTITUTION AND FINES**

One of FINRA's tools for achieving investor protection and market integrity is vigorous, fair and effective enforcement of our member firms' compliance with securities laws and regulations.

When a member firm or registered representative engages in misconduct, restitution for harmed customers is our highest priority, although there are many cases in which it is not practical. Restitution may be ordered when an investor has suffered a quantifiable loss due to misconduct. The calculation of restitution is based on the actual amount of the harm sustained by the investor, as demonstrated by evidence. We ordered restitution to harmed investors of $25.2 million during 2020. Restitution is assessed separately from fines and has no impact on how or when we use fine money. Restitution is payable to the harmed party and has no effect on our financial position.

When a member firm or registered representative engages in misconduct, we also assess whether a sanction should be imposed in order to discourage similar conduct by the firm, registered representative or others. When we impose fines, the amounts are based on the facts and circumstances of the misconduct and the principles set forth in the *FINRA Sanction Guidelines*. The National Adjudicatory Council (NAC), which is composed of industry and non-industry members, continues to maintain the *FINRA Sanction Guidelines* for use by the various bodies adjudicating FINRA disciplinary decisions, including Hearing Panels and the NAC itself, in determining appropriate remedial sanctions. FINRA publishes the *FINRA Sanction Guidelines* so that member firms, associated persons and their counsel may become more familiar with the types of disciplinary sanctions that may be applicable to various violations.

Fines are not based on FINRA revenue considerations, and we do not establish any minimum amount of fines that must be assessed for purposes of our annual budget. These monies are not considered in determining employee compensation and benefits. The total amount of fines increased by $17.5 million in 2020 to $57 million.

FINRA's use of fine monies is governed by FINRA's Financial Guiding Principles (Principles), which we published in January 2018 to provide more transparency about how we manage our financial resources to ensure we fulfill our regulatory responsibilities and further our mission. FINRA's Board reaffirmed the Principles in December 2020. As the Principles describe, FINRA accounts for fine monies separately, and any use of such monies is approved, separately from other expenditures, by the Board or its Finance Committee. The Board or its Finance Committee may authorize the use of fine monies only for one of four enumerated purposes: (1) capital/initiatives or non-recurring strategic expenditures that promote more effective and efficient regulatory oversight by FINRA (including leveraging technology and data in a secure manner) or that enable improved compliance by member firms; (2) activities to educate investors, promote compliance by member firms through education, compliance resources or similar projects, or ensure our employees are highly trained in the markets, products and businesses we regulate; (3) capital initiatives required by new legal, regulatory or audit requirements; or (4) replenishing reserves in years where such reserves drop below levels reasonably appropriate to preserve FINRA's long-term ability to fund its regulatory obligations.

In accordance with the Principles, in May 2021, FINRA issued a separate detailed report covering all projects for which we used fine monies in 2020.

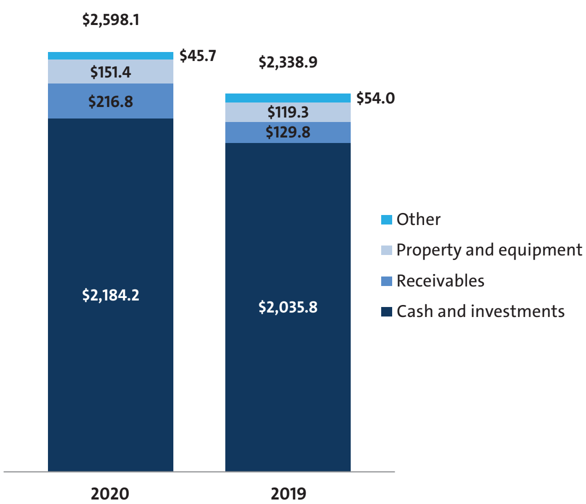
**BALANCE SHEET**

Our focus is to ensure a balance sheet that positions FINRA to fulfill our regulatory obligations and mission in today's continually evolving markets. To that end, our balance sheet remains strong, with net assets of approximately $1.5 billion as of December 31, 2020 and 2019. FINRA's working capital (excluding fines and our consolidated limited partnership, as described in Note 4, "Investments") was $1.2 billion as of December 31, 2020 and $0.9 billion as of December 31, 2019. Our working capital and cash ratios (excluding fines and our consolidated limited partnership) were 2.41 and 2.11 as of December 31, 2020, compared to 2.42 and 2.16 as of December 31, 2019. The increase in FINRA's working capital was driven by the purchase of equity (short-term) investments with proceeds from the redemption of other (long-term) investments.

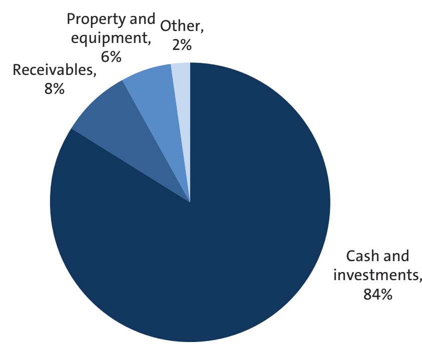
**Assets**

**Assets By Type as of December 31**

*($ in millions)*




**Assets By Type as of December 31, 2020**



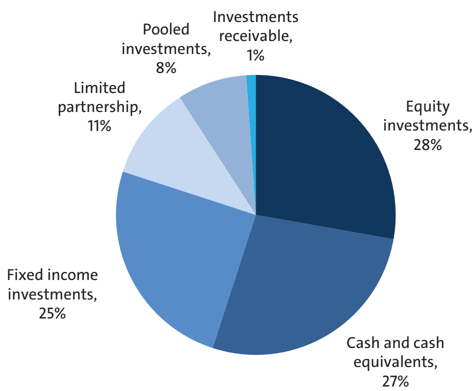
## Assets (continued)

**COMMENTARY: 2020 – 2019**

Cash and investments (cash, cash equivalents and fixed income, equity and other investments, including investments receivable) are the largest portion of FINRA's total assets, consistently representing over 80 percent of total assets annually. Our primary market risk relates to the reserve portfolio. The value of our investments is impacted by fluctuations in the economic climate, as well as changes in individual security prices associated with a diverse array of investment strategies.

Cash and investments as of December 31, 2020, are presented in the following chart.

**Cash and Investments By Type as of December 31, 2020**




Descriptions of the nature of and accounting for FINRA's investments are described in Note 2, "Summary of Significant Accounting Policies," and Note 4, "Investments," to the consolidated financial statements.

Total assets increased $259.2 million or 11.1 percent. The following table identifies the changes in assets year over year.

**Assets**
*(in millions)*

| 2020 – 2019 | |
|---|---|
| **2019** | **$2,338.9** |
| Cash and investments | 148.4 |
| Receivables | 87.0 |
| Property and equipment | 32.1 |
| All other | (8.3) |
| **2020** | **$2,598.1** |

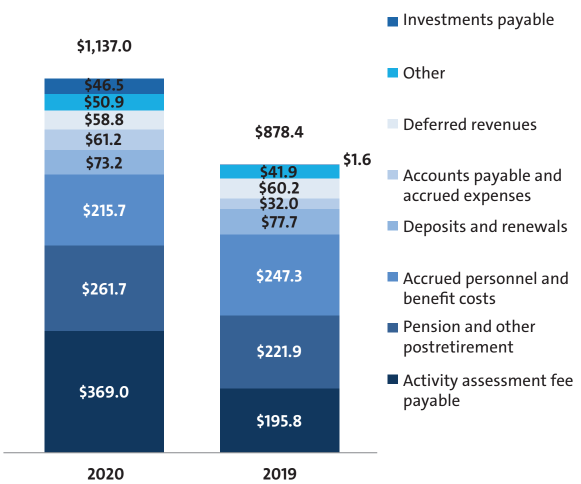
Cash and investments. Cash and investments increased, driven primarily by a higher cash balance in 2020 compared to 2019 due to an approximate 62 percent volume increase and approximate 7 percent rate increase associated with our activity assessment fees, coupled with the year-over-year TAF volume increase. FINRA assesses regulatory transaction fees in accordance with prescribed SEC fee rates; therefore, our cash, activity assessment fee receivable and activity assessment fee payable balances fluctuate year over year as a result of changes in activity volumes and SEC fee rates. Reserve portfolio returns of 1.2 percent in 2020 also contributed to the increase in cash and investments.

Receivables. Receivables increased due to activity assessment fee increases, TAF increases and our role as the CAT Plan Processor.

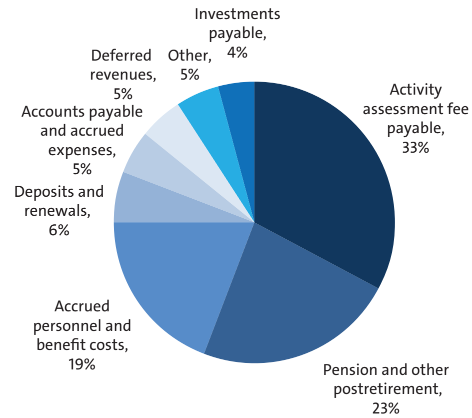
Property and equipment. The increase in property and equipment is primarily due to leasehold improvements at our New York, New York, Jersey City, New Jersey, and Woodbridge, New Jersey, offices; and the capitalization of internal use software, partially offset by the retirement of technology assets as we continue to migrate to the cloud; and depreciation and amortization, which represents the normal reduction in our property, equipment and intangible asset base year over year.

### LIABILITIES

**Liabilities By Type as of December 31**
*($ in millions)*




**Liabilities By Type as of December 31, 2020**




### COMMENTARY: 2020 – 2019

Total liabilities increased $258.6 million or 29.4 percent. The following table identifies the individually material changes in liabilities year over year.

**Liabilities**
*(in millions)*

| 2020 – 2019 | |
|---|---|
| **2019** | **$ 878.4** |
| Activity assessment fee payable | 173.2 |
| Investments payable | 44.9 |
| Pension and other postretirement | 39.8 |
| Accounts payable and accrued expenses | 29.2 |
| Accrued personnel and benefit costs | (31.6) |
| All other | 3.1 |
| **2020** | **$1,137.0** |

Activity assessment fee payable. An approximate 62 percent volume increase drove the increase in our activity assessment payable. Additionally, the assessment fee rate increased from $20.7 to $22.1 per million dollars in transactions during 2020. We remit these activity assessment fees to the U.S. Department of Treasury semiannually, in March and September.

Investments payable. Investments payable relate to security trades and other investment purchases executed on or prior to the balance sheet date, but not yet settled, as we follow trade-date accounting. Year-end balances fluctuate based on the timing and amount of pending investment activity.

Pension and other postretirement. The increase in pension and other postretirement liabilities was primarily driven by changes in actuarial assumptions and normal costs offset by asset performance related to FINRA's pension plan. The pension plan discount rate fell from 3.2 percent at December 31, 2019, to 2.5 percent at December 31, 2020.

Pension and other postretirement benefit costs represent a significant liability to FINRA in terms of both the assumptions used to estimate the liability and its portion of FINRA's total liabilities. These costs have historically represented approximately one-quarter of total liabilities on an annual basis. Further disclosures regarding the assumptions used in determining our pension and other postretirement liabilities can be found in Note 2, "Summary of Significant Accounting Policies."

Accounts payable and accrued expenses. Our expanded use of cloud computing services under our enterprise customer agreement with a third-party vendor combined with an increase in technology-driven contract labor drove the increase in accounts payable and accrued expenses.

Accrued personnel and benefit costs. A decrease in incentive compensation and VRP severance, along with payroll period end dates (timing), drove the reduction in our accrued personnel and benefit costs. FINRA restructured employee compensation effective with the July 17, 2020 paychecks. While total compensation (base salary plus incentive compensation) did not change, a higher percentage of employees' total compensation was shifted into employee base salary and, accordingly, a lower percentage was shifted into incentive compensation. Compensation for the Chief Executive Officer (CEO), Executive Vice Presidents and officers who report to the CEO, contractors, temporary employees or VRP participants was not restructured.

**LIQUIDITY AND CAPITAL RESOURCES**

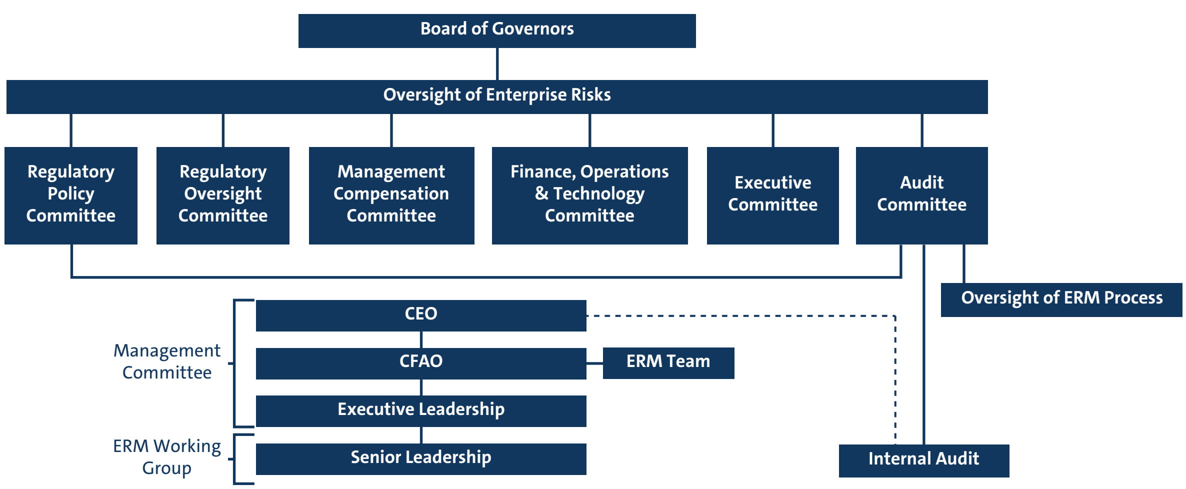
Liquidity is the ongoing ability to fund asset growth and business operations and meet contractual obligations through unrestricted access to funding at reasonable market rates. Liquidity management involves forecasting funding requirements and maintaining sufficient working capital to meet business needs and accommodate fluctuations in asset and liability levels due to changes in business operations or unanticipated events. We primarily rely on operating cash flows to fund current and future operations.

We maintain a seasonal unsecured line of credit agreement with the option to borrow up to $100 million at the LIBOR Daily Floating Rate plus 0.55 percent (0.63 percent at December 31, 2020). This line of credit was available to us from February 1, 2020, to May 31, 2020, and renewed from March 1, 2021, to May 31, 2021. The line of credit provides us with a mechanism to fund operations prior to the annual billing of the GIA and PA in April, and the subsequent receipt of those funds, without having to make redemptions from the reserve portfolio. As of December 31, 2020 and December 31, 2019, no amounts were outstanding under this line of credit.

The reserve portfolio is governed by a policy based on the degree of risk deemed appropriate for FINRA assets by the Board as applied to its investment objectives. FINRA's Investment Committee, whose members have extensive background and experience in the investment community, provides overall guidance and advice in determining the appropriate policy and allocation for the reserve portfolio. As of December 31, 2020, 72 percent of our investments are available in 30 days or less. Additional information regarding the reserve portfolio can be found in the accompanying Investment Committee Report of this 2020 Annual Financial Report.

**ENTERPRISE RISK MANAGEMENT**

FINRA's Enterprise Risk Management (ERM) program is designed to provide a consolidated, organization-wide view of the risks that FINRA faces in the execution of its mission, strategic goals and key business objectives. The program covers a broad spectrum of risks in various risk categories, such as strategic, operational, legal and compliance, and financial, and provides transparency for senior management and the Board regarding FINRA's enterprise-level risks and how they are being managed. The chart below shows the governance structure FINRA has in place to oversee and manage enterprise risk.




The Board oversees the ERM program, with oversight of the ERM process delegated to the Audit Committee and the primary oversight for each enterprise risk assigned to a specific Board committee, with support by other committees and working groups, as the need arises.

Where Board committees are assigned primary risk oversight responsibility, those committees meet to review and discuss the assigned enterprise risk with the designated risk owners, including factors impacting the risk, risk response, and risk tolerances and metrics.

Executive support and oversight of ERM is effected through the Management Committee, composed of the CEO, Chief Financial and Administrative Officer (CFAO) and other senior executives across the organization. Additionally, an ERM Working Group brings together senior managers across FINRA to provide fresh perspectives and support. FINRA's Internal Audit Department serves the ERM program in an advisory capacity.

**CYBER AND INFORMATION SECURITY**

FINRA operates a comprehensive security program designed to mitigate cyber and physical information security threats and ensure compliance with applicable data privacy regulations and laws. We base our program upon industry best practices, and are guided by federal and international standards, and data privacy laws and regulations. Cybersecurity and information security breach risks are integrated into FINRA's ERM program.

Specifically, FINRA's information-security practices and operational controls include leading practices such as a formal security assessment program used to evaluate vendor, partner and third-party security practices, and real-time logging, monitoring and alerting of security events.

FINRA's adoption of cloud technology provides numerous benefits, such as access to best-of-breed security solutions made available by the cloud provider's scale of operations. Another benefit is our ability to use micro-segmentation, or putting each server into a security zone of one, which dramatically reduces attack surface area. Cloud technology also enables us to focus on the automation and tools necessary to raise the compliance bar and simplify controls.

FINRA information technology systems are subject to numerous mandatory and voluntary inspections including, but not limited to, the following:

- regular vulnerability scans;
- application code analysis and security testing using automated scans, dynamic testing and manual attack techniques to identify application-level vulnerabilities;
- periodic independent, third-party penetration tests and application security assessments;
- regular inspections conducted by the SEC;
- an annual Service Organization Control (SOC) 2 Type II Assessment; and
- annual assessments by our Internal Audit department.

# Investment Committee Report

Year Ended December 31, 2020

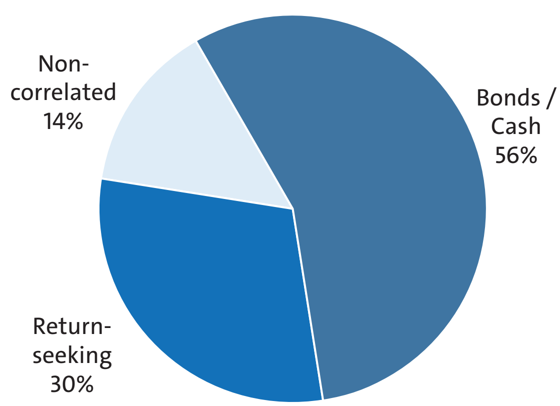
FINRA's reserve portfolio* is a pool composed of both long-term investments and short-term operating cash assets principally created with proceeds from the sale of FINRA's interests in NASDAQ about 15 years ago. The purpose of the reserve portfolio is to support FINRA's efforts to fulfill its mission by making annual operating budget contributions and for use as a source of funding strategic and unanticipated initiatives. Distributions from the reserve portfolio are subject to prior approval by the Board of Governors (Board) and may be used to defer member fee increases or make up cash flow losses, among other uses.

The Board is responsible for FINRA's reserve portfolio and approves the charter that guides the FINRA Investment Committee. The Investment Committee, a standing committee of FINRA, is composed of members of the Board and other outside investment professionals that advise the Board and provide guidance in determining the appropriate policy, guidelines and allocation for FINRA's investments. The FINRA Investment Office is responsible for management of the investments within the framework of the investment policy. FINRA engages investment consultants to support the Investment Office as needed.

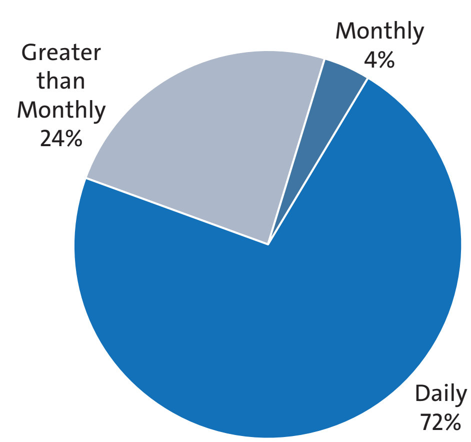
FINRA invests its reserve portfolio with the objective of creating a conservative, low-volatility portfolio designed to deliver low-to-moderate returns over the medium-term in order to support ongoing business operations. In 2020, the Investment Committee directed gradual implementation of revisions to FINRA's investment policy that were approved by the Board in December 2019. The revised policy consists of a core portfolio of bonds and stocks with an additional allocation to strategies designed to further reduce risk and lower the correlation to capital markets. The revised policy improved portfolio liquidity while remaining generally consistent with FINRA's overall risk and return framework, as determined by the Board. In 2020, the reserve portfolio returned 1.2 percent, including the operating cash balance.

The charts below show portfolio exposures and general liquidity as of December 31, 2020. Primary exposures are 56 percent bonds/cash, 30 percent return-seeking investments, and 14 percent non-correlated assets.

**Exposures as of December 31, 2020**




**Liquidity as of December 31, 2020**




* For the purposes of this Investment Committee report, FINRA's reserve portfolio includes the FINRA Investor Education Foundation's investments and investments net of their related receivables and payables on the consolidated balance sheet. The values reported exclude Section 31 fees received but not yet remitted to the U.S. Department of Treasury.

# Investment Committee Report (continued)

FINRA has established a series of Financial Guiding Principles that include a goal of maintaining a reserve balance equal to at least one year of expenditures. In 2020, FINRA submitted a regulatory filing to the U.S. Securities and Exchange Commission (SEC) to gradually introduce an increase in fees over a multi-year period, beginning in 2022. To accommodate this delayed, phased-in approach to the increase in fees, the reserve portfolio will be strategically reduced over the coming years until the target level is reached. Over this period, FINRA expects to distribute a significant portion from the reserve portfolio in order to support FINRA's operations while defraying the fee increase to member firms. During 2020, FINRA withdrew $73 million from reserve portfolio investments to finance ongoing operations. The chart below highlights portfolio asset flows in 2020.

**RESERVE PORTFOLIO FLOWS (in millions)[1]:**

| | |
|---|---|
| Beginning assets | $1,699 |
| Net portfolio flows | (73) |
| Gains (losses) | 19 |
| Change in cash | 42 |
| Ending assets | $1,687 |

FINRA has an Investments Conflicts of Interest Policy that establishes the standards governing the separation of investment activities and decisions from FINRA's regulatory operations. FINRA's investment strategy limits the direct ownership of investment assets to debt securities, mutual and commingled funds, treasury futures, limited partnership interests and shares in private investment funds. Where direct ownership of individual securities exists, all securities in the banking and brokerage sectors are held in a blind trust, in order to prohibit any knowledge of or participation in the making of such investments by any FINRA regulatory personnel, and to avoid any appearance of a conflict of interest with FINRA's responsibilities. Our limited partnership interest and our investments in public and private funds are each maintained as a pooled vehicle in which FINRA has neither management discretion nor direct ownership of the underlying investments.

Third-party providers make all implementation decisions within the reserve portfolio. With respect to internal activities, the oversight and management of the reserve portfolio is performed by the Investment Committee and limited to essential staff only, so that no individual in the regulatory arm of the organization has access to information regarding the securities within our reserve portfolio.

Members of the Investment Committee:

Jack B. Ehnes, Chair
Camille M. Busette
Charles I. Plosser
George (Gus) Sauter
Timothy C. Scheve
John W. Thiel
Jennifer A. Urdan

June 25, 2021

[1] Net portfolio flows include investment portfolio purchases and withdrawals exclusive of cash investments. Investment gains and losses include interest and dividends earned from portfolio and operating cash investments. Change in cash includes changes in the operating cash balance due to revenue and expense flow activity.

# Audit Committee Report

Year Ended December 31, 2020

The Audit Committee of the Board of Governors (Board) assists the Board in fulfilling its responsibility for Board oversight of the quality and integrity of the accounting, auditing and financial reporting practices of FINRA in accordance with the Charter adopted by the Board.

Each member of the Audit Committee is an independent director as defined by the U.S. Securities and Exchange Commission's (SEC) Rule 10A-3 under the Securities Exchange Act of 1934, Listing Standards Relating to Audit Committees. In addition, the Audit Committee and Board have determined that Jack B. Ehnes and Christopher W. Flint are audit committee financial experts, as defined by the SEC.

During 2020, the Audit Committee met four times.

The Charter and the By-Laws of FINRA make the Chief Audit Executive directly responsible to the Audit Committee. In all material respects, the Charter complies with standards applicable to publicly-owned companies. (The Charter for the FINRA Audit Committee is available at: *https://www.finra.org/about/governance/standing-committees/audit-committee-charter*.)

Additionally, the Charter gives the Audit Committee responsibility for monitoring the independence of the independent auditor, recommending the appointment of the independent auditor for approval by the Board, ensuring sufficient scope of independent auditor activities to perform an adequate financial statement audit and ensuring the independent auditor is fairly and appropriately compensated for its effort. The Charter makes clear that the independent auditor is accountable to the Audit Committee and the Board, as representatives of the members and the public. In addition, the Audit Committee discusses significant areas of the audit engagement with the independent auditor, with and without management present, as needed.

In discharging its oversight responsibility, the Audit Committee reviewed the assessments of audit risk and the audit plans of both the independent and internal auditors. The Audit Committee also discussed with management, the internal auditors, and the independent auditor the quality and adequacy of FINRA's internal controls and the internal audit organization, responsibilities, budget and staffing.

In conducting its formal annual assessment of the independent auditor, Audit Committee considerations include, but are not limited to, the following factors: (i) the most recent results from surveys conducted by management regarding the performance of the independent auditor, incorporating audit quality, the experience of the engagement team, reasonableness of audit cost, auditor independence, Public Company Accounting Oversight Board (PCAOB) inspection results of the independent auditor and the ongoing strength of the independent audit firm's reputation; (ii) the length of time the firm has served as FINRA's independent auditor; and (iii) the timeliness of the independent auditor in escalating issues and reporting results to and answering questions posed by the Audit Committee.

The lead audit partner, having primary responsibility for the audit, rotates off the engagement every five years, and the Audit Committee is involved in the selection of the lead audit partner. The current lead audit partner was appointed in July 2016. We will be rotating the lead audit partner in 2021.

Ernst & Young LLP (EY) has served as FINRA's auditor since 1986.

# Audit Committee Report (continued)

The Audit Committee obtained a written statement from EY, describing all relationships with FINRA. The Audit Committee discussed those relationships and was satisfied that none of the relationships were incompatible with the auditor's independence. The Audit Committee has reviewed and approved all services, including non-audit services, performed by EY for FINRA and the associated fees before initiation of each engagement. We have summarized such services and fees in the following table:

| | 2020 | 2019 (1) |
|---|---|---|
| Audit services (2) | $1,144,500 | $1,053,100 |
| Audit-related services (3) | 469,500 | 452,695 |
| Tax services (4) | 259,600 | 119,682 |
| All other services (5) | — | 375,000 |
| Total | $1,873,600 | $2,000,477 |

(1) FINRA has updated the 2019 fees from the prior year's report to reflect final amounts paid for the 2019 approved services.

(2) For 2020 and 2019, audit services represent the consolidated financial statement audit.

(3) Audit and attest services provided to FINRA and subsidiaries.

(4) Tax services represent fees related to tax return preparation and review services in connection with the 2020 and 2019 Form 990s and related Form 990-Ts, as well as other tax compliance, advice and planning.

(5) All other services represent advisory services to assess contract compliance related to a FINRA subsidiary.

The Audit Committee discussed and reviewed with the independent auditor all communications required by applicable professional standards. Further, the Audit Committee has reviewed and discussed with management and EY, with and without management present, the consolidated audited financial statements as of December 31, 2020, and EY's report on the consolidated financial statements. Based on those discussions, the Audit Committee recommended to the Board that FINRA's audited consolidated financial statements be included in the annual report for the year ended December 31, 2020.

Members of the Audit Committee:

Lance F. Drummond, Chair
Jack B. Ehnes
Peter R. Fisher
Christopher W. Flint
Linde Murphy

June 25, 2021

# Management Compensation Committee Report

Year Ended December 31, 2020

*FINRA Compensation Philosophy*

FINRA's compensation philosophy is a pay-for-performance model that seeks to achieve pay levels in line with the competitive market while meeting the objectives of attracting, developing and retaining high-performing individuals who are capable of achieving our mission, and to provide rewards commensurate with individual contributions and FINRA's overall performance. This philosophy applies to employees at all levels within the organization. FINRA is committed to attracting and retaining talent through offerings of programs and services in addition to compensation. FINRA focuses on employee well-being and provides an inclusive workplace that encourages career enhancement and personal growth.

In conjunction with this philosophy and based on a third-party assessment of our compensation structure, FINRA rebalanced its "pay mix" during 2020 to provide certain current employees—and offer prospective employees—a more competitively balanced compensation structure. Specifically, we shifted a higher percentage of employees' total compensation into their base salary and, accordingly, a lower percentage into incentive compensation. As a result of these changes, employees maintained an equivalent earnings opportunity, but with more guaranteed, up-front compensation in each paycheck and less pay at risk. The increase to base salaries flowed through to increases in other benefits, such as 401(k) contributions. We believe this step better positions FINRA to compete for the talent and expertise we need to protect investors, while allowing us the flexibility to incentivize performance and differentiate pay for different levels of performance. The rebalancing did not apply to the Chief Executive Officer (CEO), Executive Vice Presidents and officers who report to the CEO, contractors, temporary employees or Voluntary Retirement Program participants.

*Benchmarking*

FINRA strives to be competitive with the external market when establishing starting pay rates, annual incentives and salary structures. A number of external sources are leveraged to compile market data benchmarks that are used to help establish these structures. To determine whether compensation is comparable to the value that those skills would command on the open market, FINRA uses specific position survey data to compare skill sets and benchmark the compensation paid to FINRA executives. Ultimately, in assessing how to value staff positions, FINRA places an emphasis foremost on the demands and competitiveness of each job to ensure that FINRA is paying equitably for skills, expertise and performance level within the overall context of remaining comparable to the market.

Defining the relevant employment market for competitive compensation benchmarking purposes is a significant challenge for FINRA due to the scarcity of natural comparisons, the uniqueness of functions performed, the need for specialized expertise in financial services and securities law and a constantly changing environment.

As part of its compensation philosophy, FINRA has determined that its competitive compensation positioning for all employees should be considered primarily against a broad section of financial services and capital market companies, as this is the most likely sector from which FINRA will recruit talent, and that would recruit talent away from the Company. FINRA also benchmarks against general industry and legal industry positions for jobs that are not unique to the financial services industry. The Management Compensation Committee considers market data at the 25th and 50th percentiles, by position, when making pay decisions, but does not target executive pay specifically to a particular percentile of the market data. FINRA recognizes that it does not provide fully competitive opportunities, particularly in the equity/long-term incentive area, when compared to certain global investment and securities firms. As a result, benchmarking for key executives will follow the same philosophy but with pay positioning that may reflect or offset the lack of long-term incentives at FINRA.

In determining a benchmarking strategy for key executives, the Committee and its advisor (see next section) engaged in substantial research and consideration of the functions and operations of several potential comparisons as well as general competitive conditions. Ultimately, the Committee approved a benchmarking process for key executives that focused on the following sources:

- Public comparison group composed of a blend of public financial services organizations engaged in brokerage or other related banking activities.
- Public exchanges and regulators.
- Financial services industry survey data.
- Legal industry survey data.
- Other not-for-profit sector data.

The Committee will routinely review the aforementioned sources in determining annual salary and incentive compensation.

*Executive Compensation*

The Management Compensation Committee (the Committee), which is composed solely of public members of the Board of Governors (Board), is responsible for approving salary levels and incentive compensation ranges for the CEO and officers that report directly to the CEO. In determining salary and incentive compensation, management and the Committee consider operational, strategic and financial factors in addition to individual performance. Compensation determinations have no direct relationship to fines or changes in membership fees. The salary and incentive compensation recommendations for the CEO are reviewed and approved by the Board annually. The Committee met five times during 2020.

The Committee has the sole right and responsibility to hire and terminate a compensation consultant. The Committee engaged Meridian Compensation Partners, LLC (Meridian), an independent third-party compensation consultant, to prepare a compensation study, which included objective analysis of current compensation levels and benchmarking using information from comparable segments of the market for key executives. To ensure the independence of Meridian:

- Meridian reported directly and exclusively to the Committee;
- no Meridian employee is hired by FINRA;
- Meridian provided no significant services, other than compensation consulting services, to FINRA;
- any interaction between Meridian and FINRA executive management is limited to discussions on matters under the purview of the Committee and information that is presented to the Committee for approval; and
- fees paid to Meridian for compensation consulting services are reasonable and in line with industry standards.

# Management Compensation Committee Report (continued)

*Summary Compensation Table*

Salary information represents the base annual salary at which the named executives are compensated, as of June 30 of each year. It does not represent year-to-date earnings. The incentive compensation amounts represent the actual payment in March of each year based on prior year performance. Other amounts, including deferred compensation and other benefits, are not presented for 2021, as these accumulate over the course of the year and final amounts are not determined until year-end. The top five executives are determined based on total 2021 salary and incentive compensation as described above.

Compensation totals align with the reporting requirements for FINRA's annual Form 990 *Return of Organization Exempt from Income Tax*. Compensation information for additional executives is also reported in Form 990. For descriptions of the various components of compensation in the table below, refer to the next page.

| Name and principal position | | Salary (1) | Incentive compensation | Other compensation and deferrals | Other benefits | Total |
|---|---|---|---|---|---|---|
| Robert W. Cook | 2021 | 1,000,000 | 1,750,000 | * | * | 2,750,000 |
| President and Chief Executive Officer | 2020 | 1,000,000 | 1,500,000 | 575,532 | 44,031 | 3,119,563 |
| | 2019 | 1,000,000 | 1,500,000 | 632,966 | 25,326 | 3,158,292 (1) |
| Todd T. Diganci | 2021 | 610,000 | 750,000 | * | * | 1,360,000 |
| EVP, Chief Financial and | 2020 | 610,000 | 700,000 | 111,360 | 55,015 | 1,476,375 |
| Administrative Officer | 2019 | 600,000 | 685,000 | 1,327,263 | 50,930 | 2,663,193 |
| Steven J. Randich | 2021 | 510,000 | 700,000 | * | * | 1,210,000 |
| EVP and Chief Information Officer | 2020 | 510,000 | 650,000 | 178,011 | 28,985 | 1,366,996 |
| | 2019 | 500,000 | 580,000 | 243,302 | 28,296 | 1,351,598 |
| Robert L.D. Colby | 2021 | 510,000 | 585,000 | * | * | 1,095,000 |
| EVP and Chief Legal Officer | 2020 | 510,000 | 545,000 | 164,081 | 23,949 | 1,243,030 |
| | 2019 | 500,000 | 500,000 | 143,072 | 20,221 | 1,163,293 |
| Bari Havlik | 2021 | 500,000 | 565,000 | * | * | 1,065,000 |
| EVP, Member Supervision | 2020 | 500,000 | 625,000 | 161,030 | 26,830 | 1,312,860 |
| | 2019 | 490,000 | 475,000 (2) | 137,253 | 28,188 | 1,130,441 |

* 2021 deferred compensation and other benefits cannot be fully determined until the end of the calendar year and are therefore not included in the above table.

1 In 2019, Mr. Cook contributed $150,000 of his 2018 incentive compensation (less estimated taxes payable by him) to the FINRA Investor Education Foundation. After consideration of this contribution, Mr. Cook's total compensation for 2019 was effectively $3,008,292.

2 Reflects a partial year incentive payment for Mrs. Havlik who joined FINRA after the beginning of 2018.

# Management Compensation Committee Report (continued)

*Components of Compensation*

Salary

- Base salaries for all employees align with job-grade structures to provide for appropriate flexibility in hiring and retention. Actual salaries are based on job content, performance and relevant experience levels, and may fall above or below competitive levels.

Incentive Compensation

- Incentive compensation is available to all employees and is an additional “at-risk” compensation that is performance-based and determined in relation to individual achievements and FINRA’s overall performance. The size of the actual award varies based on goal achievement, performance, grade level and degree of responsibility within the organization. If awarded, it is paid as a lump sum in March of the following year.

Other Compensation and Deferrals

- Pension and 401(k) deferral and matching programs are generally available to all employees. The pension plan may be either defined contribution or defined benefit depending on employee hire date and years of service.
- Certain employees at both the officer and non-officer level may receive a special deferred compensation retention plan. Amounts are reported in the year earned, which may be different from the year in which they are paid, especially in multi-year retention plans.
- Supplemental retirement benefits are provided for top executives. These plans, which may be either defined benefit or defined contribution, are non-qualified and are based on salary, officer level, and, depending on officer level, a portion of incentive compensation. Annual non-vested contributions and current net vesting contributions are reported as part of other compensation and deferrals.
- The defined benefit plans noted above, both pension and supplemental, may experience fluctuations due to changes in discount rates and other actuarial factors. These fluctuations may result in significant valuation changes, both positive and negative, that affect the reported compensation in any given year.

Other Benefits

Other benefits include taxable and non-taxable health and welfare benefits such as employer-paid health, life and disability insurance that are generally available to all employees. On occasion, it may also include miscellaneous taxable fringe benefits such as parking, travel subsidies and similar minor items.

Members of the Management Compensation Committee:

Eileen K. Murray, Chair
Lance F. Drummond
Eric Noll
Hillary A. Sale

June 25, 2021

# Management Report on Internal Control Over Financial Reporting

FINRA management is responsible for the preparation and integrity of the consolidated financial statements appearing in our annual report. The consolidated financial statements were prepared in conformity with U.S. generally accepted accounting principles (U.S. GAAP) and include amounts based on management's estimates and judgments. FINRA management is also responsible for establishing and maintaining adequate internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. Internal control over financial reporting is a process designed by management to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with U.S. GAAP.

FINRA maintains a system of internal control that is designed to provide reasonable assurance as to the fair and reliable preparation and presentation of the consolidated financial statements, as well as to safeguard assets from unauthorized use or disposition that could have a material effect on the consolidated financial statements. FINRA's internal control over financial reporting includes written policies and procedures that 1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of FINRA's assets; 2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with U.S. GAAP, and that receipts and expenditures of FINRA are being made only in accordance with authorizations of FINRA's management and governors; and 3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of FINRA's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements due to error or fraud, including the possibility of the circumvention or overriding of controls. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision of the President and Chief Executive Officer and the Chief Financial and Administrative Officer, FINRA's management assessed the effectiveness of FINRA's internal control over financial reporting as of December 31, 2020. This evaluation included, among other things, reviews of the documentation of controls, evaluations of the design effectiveness of controls and reviews of evidence supporting the operating effectiveness of controls. Based on this assessment, we conclude that FINRA maintained effective internal control over financial reporting as of December 31, 2020.

June 25, 2021

Robert W. Cook
President and Chief Executive Officer

Todd T. Diganci
Executive Vice President – Chief Financial and Administrative Officer

# Report of Independent Registered Public Accounting Firm

To the Board of Governors of
Financial Industry Regulatory Authority, Inc.

**Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheets of the Financial Industry Regulatory Authority, Inc. (FINRA or the Company) as of December 31, 2020 and 2019, the related consolidated statements of operations, comprehensive income (loss), changes in equity and cash flows for the years then ended, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of FINRA at December 31, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

**Basis for Opinion**

These financial statements are the responsibility of FINRA's management. Our responsibility is to express an opinion on FINRA's financial statements based on our audits. We are required to be independent with respect to FINRA in accordance with the relevant ethical requirements relating to our audits.

We conducted our audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

**Critical Audit Matters**

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

***Pension and Other Postretirement Benefit Obligations***

***Description of the Matter***

At December 31, 2020, the Company's defined benefit pension obligation and other postretirement benefit obligation balances were $164.0 million and $97.7 million, respectively. As discussed in Note 7 to the financial statements, the Company makes significant subjective judgments about a number of actuarial assumptions for these obligations, which includes the discount rate, the rate of compensation increase and the expected return on plan assets. The Company updates the actuarial estimates used to measure these obligations to reflect updated participant data, actuarial assumptions and actual return on plan assets, among others.

# Report of Independent Registered Public Accounting Firm (continued)

Auditing management's estimate of the defined benefit pension obligation and the other postretirement benefit obligation was complex and involved a greater extent of audit effort, including involving firm specialists to assess the actuarial assumptions used in the measurement of the obligations.

***How We Addressed the Matter in Our Audit***

We obtained an understanding of the processes relating to the measurement and valuation of the defined benefit pension and other postretirement benefit obligations, and the related internal controls. This included, among others, controls over the review and approval processes that management has in place for the methods and assumptions used in estimating the obligations.

To test these obligations, we performed audit procedures that included, among others, evaluating the results of the actuarial valuation reports prepared by management's third party actuarial specialists and reconciling the results of the actuarial valuation reports to the Company's recorded obligations. We tested the completeness and accuracy of the underlying participant data used by management's third party actuarial specialists through testing of the reconciliation of the participant data recorded in the Company's source systems to the actuarial valuation report and comparing a sample of participant data to source documentation. With the assistance of our actuarial specialists, we assessed the methodology used by management with the methodology used in prior periods and those used in the industry. To evaluate the key assumptions noted above used in the actuarial valuation reports, we compared them to independently developed expectations using publicly available data.

Ernst + Young LLP

We have served as FINRA's auditor since 1986.

Tysons, Virginia
June 25, 2021

# FINRA Consolidated Balance Sheets

*(In millions)*

| | December 31, | |
|---|---|---|
| | 2020 | 2019 |
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 597.3 | $ 387.6 |
| Investments: | | |
| Fixed income, at fair value | 538.1 | 617.5 |
| Equity, at fair value | 621.7 | 356.9 |
| Receivables, net | 216.8 | 129.8 |
| Investments receivable | 16.8 | 5.2 |
| Other current assets | 23.6 | 25.2 |
| Total current assets | 2,014.3 | 1,522.2 |
| Property and equipment: | | |
| Land, buildings and improvements | 129.3 | 128.6 |
| Data-processing equipment and software | 156.3 | 137.7 |
| Furniture, equipment and leasehold improvements | 92.7 | 67.5 |
| | 378.3 | 333.8 |
| Less accumulated depreciation and amortization | (226.9) | (214.5) |
| Total property and equipment, net | 151.4 | 119.3 |
| Other investments: | | |
| Investments of Consolidated Entity, at fair value | 238.9 | 217.3 |
| Pooled investment funds, at fair value | 171.1 | 451.0 |
| All other | 0.3 | 0.3 |
| Other assets | 22.1 | 28.8 |
| **Total assets** | $2,598.1 | $2,338.9 |

*See accompanying notes.*

# FINRA Consolidated Balance Sheets (continued)

*(In millions)*

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| **Liabilities and equity** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 61.2 | $ 32.0 |
| Accrued personnel and benefit costs | 217.3 | 245.5 |
| Deferred revenue | 58.8 | 60.2 |
| Deposits and renewals | 73.2 | 77.7 |
| Investments payable | 46.5 | 1.6 |
| Other current liabilities | 6.9 | 7.6 |
| Activity assessment fee payable | 369.0 | 195.8 |
| Total current liabilities | 832.9 | 620.4 |
| Accrued pension and other postretirement benefit costs | 257.5 | 209.0 |
| Long-term debt | 11.9 | 12.8 |
| Other liabilities | 34.7 | 36.2 |
| **Total liabilities** | 1,137.0 | 878.4 |
| Equity | 1,600.6 | 1,580.8 |
| Accumulated other comprehensive loss | | |
| Net unrecognized employee benefit plan amounts | (139.5) | (120.3) |
| **Total equity** | 1,461.1 | 1,460.5 |
| **Total liabilities and equity** | $2,598.1 | $2,338.9 |

*See accompanying notes.*

# FINRA Consolidated Statements of Operations

*(In millions)*

| | Years Ended December 31, 2020 | 2019 |
|---|---|---|
| **Revenues** | | |
| Operating revenues | | |
| Regulatory revenues | $ 611.4 | $ 483.6 |
| User revenues | 306.5 | 290.1 |
| Contract services revenues | 187.7 | 125.3 |
| Total operating revenues | 1,105.6 | 899.0 |
| Fines | 57.0 | 39.5 |
| Activity assessment revenues | 1,033.8 | 533.0 |
| Total revenues | 2,196.4 | 1,471.5 |
| Activity assessment cost of revenues | (1,033.8) | (533.0) |
| **Net revenues** | 1,162.6 | 938.5 |
| **Expenses** | | |
| Compensation and benefits | 736.0 | 758.5 |
| Professional and contract services | 193.9 | 165.3 |
| Cloud computing and software | 120.3 | 65.7 |
| Occupancy | 43.4 | 40.5 |
| Depreciation and amortization | 20.3 | 16.9 |
| General and administrative | 41.2 | 48.1 |
| **Total expenses** | 1,155.1 | 1,095.0 |
| Interest and dividend income | 23.4 | 32.9 |
| **Operating income (loss)** | 30.9 | (123.6) |
| **Other (expense) income** | | |
| Net realized and unrealized investment gains | 3.9 | 90.9 |
| Other expense | (15.0) | (13.2) |
| **Net income (loss)** | $ 19.8 | $ (45.9) |

*See accompanying notes.*

# FINRA Consolidated Statements of Comprehensive Income (Loss)

*(In millions)*

| | Years Ended December 31, | |
|---|---|---|
| | 2020 | 2019 |
| **Net income (loss)** | $ 19.8 | $(45.9) |
| Employee benefit plan adjustments | (19.2) | (38.7) |
| **Comprehensive income (loss)** | $ 0.6 | $(84.6) |

*See accompanying notes.*

# FINRA Consolidated Statements of Changes in Equity

*(In millions)*

| | Equity | Accumulated Other Comprehensive Loss: Unrealized Gain (Loss) on Available-for-Sale Investments | Accumulated Other Comprehensive Loss: Net Unrecognized Employee Benefit Plan Amounts | Total |
|---|---|---|---|---|
| **Balance, January 1, 2019** | $1,606.6 | $(0.6) | $ (81.6) | $1,524.4 |
| Cumulative effect from change in accounting policies (1) | 20.1 | 0.6 | — | 20.7 |
| Comprehensive loss | (45.9) | — | (38.7) | (84.6) |
| **Balance, December 31, 2019** | 1,580.8 | — | (120.3) | 1,460.5 |
| Comprehensive income | 19.8 | — | (19.2) | 0.6 |
| **Balance, December 31, 2020** | $1,600.6 | $ — | $(139.5) | $1,461.1 |

(1) Effective January 1, 2019, we adopted ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. See Note 2, “Summary of Significant Accounting Policies,” for more information.

*See accompanying notes.*

# FINRA Consolidated Statements of Cash Flows

*(In millions)*

| | Years Ended December 31, | |
|---|---|---|
| | 2020 | 2019 |
| **Reconciliation of net income (loss) to cash provided by operating activities** | | |
| Net income (loss) | $ 19.8 | $(45.9) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 20.3 | 16.9 |
| Net realized and unrealized investment gains | (3.9) | (90.9) |
| Bad debt expense | 11.2 | 3.6 |
| Other | 1.0 | 1.5 |
| Net change in operating assets and liabilities: | | |
| Receivables, net | (95.2) | (14.8) |
| Other current assets | 2.0 | (1.9) |
| Other assets | 4.2 | (0.3) |
| Accounts payable and accrued expenses | 22.1 | 5.0 |
| Accrued personnel and benefit costs | (28.2) | 45.2 |
| Deferred revenue | (1.4) | 1.1 |
| Deposits and renewals | (4.5) | 6.3 |
| Activity assessment fee payable | 173.2 | 55.4 |
| Other current liabilities | (0.7) | (0.5) |
| Accrued pension and other postretirement benefit costs | 29.3 | 22.9 |
| Other liabilities | (1.5) | 11.2 |
| **Net cash provided by operating activities** | $147.7 | $ 14.8 |

*See accompanying notes.*

# FINRA Consolidated Statements of Cash Flows (continued)

*(In millions)*

| | Years Ended December 31, | |
|---|---|---|
| | 2020 | 2019 |
| **Cash flow from investing activities** | | |
| Net proceeds from sales (purchases) of fixed income securities | $ 145.3 | $ (72.9) |
| Proceeds from redemptions of equity investments | 50.2 | 87.4 |
| Purchases of equity investments | (270.4) | (15.2) |
| Purchases of other investments | (72.7) | (153.5) |
| Proceeds from redemptions of other investments | 250.8 | 37.5 |
| Net purchases of property and equipment | (43.7) | (20.4) |
| Other | (3.7) | (1.8) |
| *Cash flow from investing activities of the Consolidated Entity:* | | |
| Purchases of other investments | (59.8) | (43.0) |
| Proceeds of redemptions of other investments | 67.2 | 247.2 |
| **Net cash provided by investing activities** | 63.2 | 65.3 |
| **Cash flow from financing activities** | | |
| Debt principal payments | (1.2) | (1.1) |
| **Net cash used in financing activities** | (1.2) | (1.1) |
| Increase in cash and cash equivalents | 209.7 | 79.0 |
| Cash and cash equivalents at beginning of year | 387.6 | 308.6 |
| **Cash and cash equivalents at end of year** | $ 597.3 | $ 387.6 |

*See accompanying notes.*

# FINRA 2020 Notes to Consolidated Financial Statements

**1. ORGANIZATION AND NATURE OF OPERATIONS**

References to the terms “we,” “our,” “us,” “FINRA” or the “Company” used throughout these Notes to Consolidated Financial Statements refer to the Financial Industry Regulatory Authority, Inc. (FINRA), a Delaware corporation, and its wholly owned subsidiaries. FINRA wholly owns the following significant subsidiaries: FINRA Regulation, Inc. (FINRA REG), FINRA CAT, LLC (FINRA CAT), and the FINRA Investor Education Foundation (the Foundation). The Foundation is a tax-exempt membership corporation incorporated in the State of Delaware, with FINRA as the sole member.

We are a self-regulatory organization (SRO) for brokerage firms doing business with the public in the United States. We regulate the activities of U.S. broker-dealers and perform market regulation pursuant to our own statutory responsibility and under contract for certain exchanges. Our statutory regulatory functions include examinations of securities firms, continuous surveillance of markets, reviews of fraud allegations, and disciplinary actions against firms and registered representatives. FINRA’s examination process is risk-based, meaning our approach for identifying firms for examination is based upon risk, scale and scope of firm operations. We conduct examinations to determine whether firms are in compliance with federal securities laws and FINRA rules, as well as in response to investor complaints, terminations of brokerage employees for cause, arbitrations and referrals from other regulators. FINRA operates unique equity and options cross-market surveillance programs. Employing advanced technology, these programs collect and integrate trading data across exchanges and alternative trading systems to detect potential market manipulation and other rule violations. We conduct heightened and expedited investigations of allegations of serious fraud to prevent further harm to investors. We bring disciplinary actions against firms and their employees that may result in sanctions, including censures, fines, suspensions and, in egregious cases, expulsions or bars from the industry. In appropriate cases, we require firms and individuals to provide restitution to harmed investors and often impose other conditions on a firm’s business to prevent repeated wrongdoing.

We perform market regulation services under contract for the New York Stock Exchange LLC (NYSE), NYSE Arca, Inc., NYSE American, LLC, NYSE Chicago, Inc., NYSE National, Inc., The Nasdaq Stock Market LLC (Nasdaq), Nasdaq BX, Inc., Nasdaq PHLX LLC, Nasdaq ISE, LLC, Nasdaq GEMX, LLC, Nasdaq MRX, LLC, Cboe Exchange, Inc., Cboe C2 Exchange, Inc., Cboe BZX Exchange, Inc., Cboe BYX Exchange, Inc., Cboe EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., The Investors Exchange, the Boston Options Exchange, LLC, the Long-Term Stock Exchange, the Members Exchange, and the Miami International Securities Exchange, LLC, MIAX EMERALD LLC, and MIAX PEARL LLC. We also regulate the over-the-counter (OTC) securities markets for listed and unlisted equities and conventional options, and the OTC markets for corporate bonds, Treasury securities and other government agency instruments, asset-backed instruments, municipal securities and other fixed income instruments.

We provide arbitration and mediation services to assist in the resolution of monetary and business disputes between and among investors, broker-dealers and individual brokers. We also provide dispute resolution services for several exchanges through contractual agreements, thereby offering consistent procedures and the uniformity of a single forum for the resolution of securities industry-related disputes.

We provide technology-driven registration, testing and continuing education, and other regulatory services, as well as operational and support services to firms, other SROs, the U.S. Securities and Exchange Commission (SEC), the North American Securities Administrators Association, state regulators, the investing public, and the Conference of State Bank Supervisors and its wholly owned subsidiary, the State Regulatory Registry LLC (SRR). We continue to provide BrokerCheck®, a free tool that helps investors research the professional backgrounds of current and former FINRA-registered brokerage firms and brokers, as well as investment adviser firms and representatives.

We are committed to ensuring that investors and market participants have access to market information, so they can more effectively assess securities prices and valuations, through the management and operation of FINRA’s OTC market transparency facilities. These facilities include the Trade Reporting and Compliance Engine (TRACE) for fixed income

**1. ORGANIZATION AND NATURE OF OPERATIONS (CONTINUED)**

securities, the OTC Reporting Facility™ (ORF™) and OTC Bulletin Board® (OTCBB®) for equity securities not listed on an exchange and the Trade Reporting Facilities® (TRFs®), operated in partnership with NYSE and Nasdaq, for OTC trade reporting, as well as the Alternative Display Facility® (ADF®) for OTC trade reporting and quoting, in equity securities that are listed on an exchange. In this capacity, we provide the public and professionals with timely trade information for equity and debt securities and quotes for certain equity securities.

Pursuant to a contract with Consolidated Audit Trail, LLC, FINRA CAT is responsible for all aspects of the build, maintenance and operation of the Consolidated Audit Trail (CAT), which will allow regulators to improve securities market surveillance by creating an extensive audit trail of trades, quotes and orders for all U.S. exchange-listed and OTC equity securities across all U.S. markets and trading venues. The CAT will also collect the same data for all U.S. exchange-listed options.

The Foundation empowers underserved Americans with the knowledge, skills and tools to make sound financial decisions throughout life. The Foundation accomplishes this mission through educational programs and research that help consumers achieve their financial goals and that protect them in a complex and dynamic world.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

BASIS OF PRESENTATION

The accompanying consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include the accounts of the Company, its wholly owned subsidiaries and the Consolidated Entity. We account for the Consolidated Entity, a variable interest entity (VIE) for which the Company is the primary beneficiary, as an investment company that follows the industry specialized basis of accounting established by U.S. GAAP.

All intercompany balances and transactions have been eliminated in consolidation.

USE OF ESTIMATES

The preparation of these consolidated financial statements requires management to make estimates and assumptions, including estimates of fair value of investments, valuation of investments and assumptions related to our benefit plans, and the estimated service periods related to our recognition of certain revenue, that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could materially differ from those estimates.

CONSOLIDATION

FINRA consolidates any VIE in which it is deemed to be the primary beneficiary and reflects the assets, liabilities, revenues, expenses and cash flows of the consolidated VIE on the consolidated financial statements. An entity is determined to be the primary beneficiary if it holds a controlling financial interest. A controlling financial interest is defined as (a) the power to direct the activities of a VIE that most significantly impact the entity's economic performance; and (b) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. The consolidation guidance requires an analysis to determine (a) whether an entity in which the Company holds a variable interest is a VIE; and (b) whether the Company's involvement, through holding interests directly or indirectly in the entity or contractually through other variable interests such as management and performance-based fees, would give it a controlling financial interest. Performance of that analysis requires the exercise of judgment.

The Company determines whether it is the primary beneficiary of a VIE at the time it becomes involved with a VIE and reconsiders that conclusion at each reporting date. In evaluating whether the Company is the primary beneficiary, FINRA evaluates its economic interests in the entity held either directly by the Company or indirectly through related parties. The consolidation analysis can generally be performed qualitatively; however, if it is not readily apparent that the Company is not the primary beneficiary, a quantitative analysis may also be performed.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Investments and redemptions (either by the Company, affiliates of the Company or third parties) or amendments to the governing documents of a VIE could affect an entity's status as a VIE or the determination of the primary beneficiary. At each reporting date, the Company assesses whether it is the primary beneficiary and will consolidate or deconsolidate accordingly.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include demand cash, cash held in banks, money market funds and all non-restricted, highly liquid investments with maturities of 90 days or less when acquired.

Additionally, cash held at the Consolidated Entity, included in cash and cash equivalents in the consolidated balance sheets, may include overnight investments and money market funds held with financial institutions. As of December 31, 2020 and 2019, the Consolidated Entity held no cash and cash equivalents in foreign currencies. Cash held at the Consolidated Entity represents cash that may only be used to settle obligations of the Consolidated Entity. Although not legally restricted, this cash is not available to fund the general liquidity needs of FINRA.

INVESTMENTS

*Fixed Income Investments*

At the time of purchase, we classify individual fixed income investments as trading, available-for-sale or held-to-maturity based on the type of security and our intent and ability to sell or to hold the securities, and re-evaluate the classification at each balance sheet date. As of December 31, 2020, all of our fixed income investments were classified as trading. Trading securities are carried at fair value, with changes in fair value recorded as a component of net realized and unrealized investment gains in the consolidated statements of operations. We present cash flows from purchases and sales of trading securities as investing activities based on the nature and purpose for which we acquired the securities.

Fair value is determined based on quoted market prices, when available, or on estimates provided by external pricing sources or dealers who make markets in such securities. Realized gains and losses on sales of securities are included in earnings using the average cost method. Investment receivables or payables relate to security trades and other investment redemptions or purchases executed on or prior to the balance sheet date, but not yet settled, as we follow trade-date accounting.

*Equity Investments*

We carry our equity security investments at fair value and record the subsequent changes in fair value in the consolidated statement of operations as a component of net realized and unrealized investment gains.

*Other Investments*

Investments held in the Consolidated Entity include pooled investment vehicles without a readily determinable fair value. These investments are generally valued at the most recent net asset value per unit or capital account information from the general partners of such vehicles. Investment transactions are accounted for on a trade-date basis. For the purposes of determining net realized gains and losses, the Consolidated Entity uses a specific identification methodology.

FINRA elected the fair value option for its investments in pooled investment funds to better reflect the value of these investments. Such election is irrevocable and applied on a financial instrument by financial instrument basis at initial recognition. These pooled investment funds calculate net asset value per share (or its equivalent) as the investment account value in the absence of readily ascertainable market values to determine fair value.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

RECEIVABLES, NET

The Company's receivables are primarily concentrated with FINRA-registered firms, associated persons and exchanges. The consolidated financial statements present receivables net of an allowance for uncollectible accounts. As of December 31, 2020 and 2019, an allowance for uncollectible accounts of $3.2 million and $8.4 million, respectively, was presented in the accompanying consolidated balance sheets within receivables, net. We calculate the allowance based on the age, source of the underlying receivable and past collection experience. We maintain the allowance at a level that management believes to be sufficient to absorb estimated losses inherent in our accounts receivable portfolio. The allowance as of December 31, 2020, primarily related to arbitration activities, while the allowance as of December 31, 2019, primarily related to arbitration activities and fines. The allowance is increased by the provision for bad debts, which is charged against operating results and decreased by the amount of charge-offs, net of recoveries. We base the amount charged against operating results on several factors, including a periodic assessment of the collectability of each account. In circumstances where a specific firm's inability to meet its financial obligations is known (*e.g.*, bankruptcy filings), we record a specific provision for bad debts to reduce the receivable to the amount we reasonably believe will be collected.

PROPERTY AND EQUIPMENT

FINRA records property and equipment at cost less accumulated depreciation. We expense repairs and maintenance costs as incurred. We calculate depreciation and amortization as follows:

| Asset category | Depreciation/amortization method | Estimated useful lives |
|---|---|---|
| Buildings and improvements | Straight-line | 10 to 40 years |
| Data-processing equipment and software | Straight-line | 2 to 5 years |
| Furniture and equipment | Straight-line | 5 to 10 years |
| Leasehold improvements | Straight-line | Shorter of term of lease or useful life of improvement |

Depreciation and amortization expense for property and equipment totaled $10.3 million and $10.4 million for 2020 and 2019, respectively.

SOFTWARE COSTS

FINRA capitalizes internal use software development costs incurred during the application development stage. Software costs incurred prior to or subsequent to the application development stage are charged to expense as incurred. We capitalize significant purchased application software and operational software programs that are an integral part of hardware, and amortize them using the straight-line method over their estimated useful life, generally two to five years. We expense all other purchased software as incurred.

Unamortized capitalized software development costs of $42.7 million and $29.8 million as of December 31, 2020 and 2019, were included in the consolidated balance sheets within total property and equipment, net. There were $21.2 million and $16.5 million of net additions to capitalized software related to 2020 and 2019. Amortization of capitalized internal use software costs totaled $8.3 million and $4.7 million related to 2020 and 2019 and was included in depreciation and amortization in the consolidated statements of operations.

IMPAIRMENT OF LONG-LIVED ASSETS

We review our long-lived assets for impairment whenever facts and circumstances indicate that long-lived assets or other assets may be impaired. If indicators are present, we perform an evaluation of recoverability that compares the estimated future, undiscounted cash flows associated with the asset to the asset's carrying amount. If the evaluation fails the recoverability test, we then prepare a discounted cash flow analysis to estimate fair value and the amount of any

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

impairment. In 2020 and 2019, there were no indicators of long-lived asset impairment, and we did not recognize impairment charges.

DEPOSIT AND RENEWAL LIABILITIES

FINRA's deposit and renewal liabilities primarily represent deposits into our Central Registration Depository (CRD®) system. FINRA-registered firms use these deposits to pay for services, including registration fees that states and other SROs charge.

ACTIVITY ASSESSMENT FEE PAYABLE

FINRA, as an SRO, pays certain fees and assessments pursuant to Section 31 of the Securities Exchange Act of 1934. These fees are designed to recover costs incurred by the government for the supervision and regulation of securities markets and securities professionals, and are calculated based on the aggregate dollar amount of sales of covered securities transacted by or through any firm other than on a national securities exchange. Such covered transactions are reported to us through the TRFs and ORF. We remit these activity assessment fees to the U.S. Department of Treasury semiannually, in March and September.

We recover the cost of the Section 31 fees and assessments through an activity assessment, charged to the firm responsible for clearing the transaction, based on the aggregate dollar amount of sales of covered securities transacted by or through any firm other than on a national securities exchange. As of December 31, 2020 and 2019, we had $101.9 million and $51.9 million, respectively, of activity assessment fee receivables presented in the accompanying consolidated balance sheets within receivables, net.

INTEREST AND DIVIDEND INCOME

FINRA recognizes interest income from cash, fixed income and equity investments as it is earned. Dividend income is recognized on the ex-dividend date. Interest and dividend income from the Consolidated Entity is accounted for in the same manner.

CLOUD COMPUTING

We account for our cloud computing arrangement as a service contract and expense applicable costs as incurred. As our hosting arrangement does not give us the contractual right to the software at any time during the hosting period without penalty, we are not deemed to have a software license. Cloud computing costs totaled $78.2 million and $27.4 million for the years ended December 31, 2020 and 2019, respectively, and were included in cloud computing and software expenses in the consolidated statements of operations.

PENSION AND OTHER POSTRETIREMENT LIABILITIES

FINRA provides two non-contributory defined benefit pension plans for the benefit of eligible employees. The non-contributory defined benefit plans consist of a qualified Employees Retirement Plan (ERP) and a non-qualified Supplemental Executive Retirement Plan (SERP). Both plans are now closed to new participants. We also offer access to retiree medical coverage for eligible retirees and their dependents. Eligible retirees pay the full premium cost to be enrolled in the Company's retiree medical coverage. Additionally, we provide a Retiree Medical Savings Plan to help our retirees offset health care premiums during retirement. Under the Retiree Medical Savings Plan, employer-funded defined contribution Retiree Medical Accounts are created for eligible employees and fixed annual credits are applied to those accounts for each year of FINRA service beginning at age 40.

In calculating the expense and liability related to all of the abovementioned plans, we use several statistical and other factors, which attempt to anticipate future events. Key factors include assumptions about the expected rates of return on plan assets and the discount rate as determined by FINRA, within certain guidelines, as well as assumptions regarding

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

future salary increases, mortality, turnover, retirement ages and the medical expense trend rate. We consider market conditions, including changes in investment returns and interest rates, in making these assumptions. The discount rate used in the calculations is developed using a composite yield curve analysis based on a portfolio of high-quality, non-callable, marketable bonds. We determine the long-term rate of return based on analysis of historical and projected returns as prepared by our actuary and external investment consultant. FINRA's Pension/401(k) Plan Committee (the Pension Committee) reviews and advises FINRA management on both the expected long-term rate of return and the discount rate assumptions. Amortization of net gain or loss included in accumulated other comprehensive loss reflects a corridor based on 10 percent of the greater of the projected benefit obligation or the market-related value of plan assets as of the beginning of the plan year, and is included as a component of net periodic pension cost.

The actuarial assumptions that we use in determining pension and other postretirement liabilities and expenses may differ materially from actual results due to changing market and economic conditions, as well as early withdrawals by terminating plan participants. While we believe that the assumptions used are appropriate, differences in actual experience or changes in assumptions related to the ERP may materially affect our financial position. A 25 basis-point increase (decrease) in the discount rate assumption as of December 31, 2020, would cause the ERP projected benefit obligation to decrease (increase) by approximately $24.3 million.

INCOME TAXES

FINRA and FINRA REG are tax-exempt organizations under Internal Revenue Code (IRC) Section 501(c)(6). FINRA CAT is treated as a disregarded entity for federal income tax purposes in accordance with single member limited liability company rules. The Foundation is a tax-exempt organization under IRC Section 501(c)(4). However, unrelated business income activities are taxed at normal corporate rates to the extent that they result in taxable net income. We determine deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities (*i.e.*, temporary differences). We measure these assets and liabilities at the enacted rates that we expect will be in effect when we will realize these differences. We also determine deferred tax assets based on the amount of net operating loss carryforwards. If necessary, we establish a valuation allowance to reduce deferred tax assets to the amount that is more likely than not to be realized.

The Consolidated Entity has elected to be taxed as a Partnership for U.S. federal tax purposes. FINRA is responsible for reporting income or loss from the Consolidated Entity, to the extent required by the federal and state income tax laws, for income tax purposes.

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject us to concentrations of credit risk consist of cash and cash equivalents, investments and accounts receivable. We do not require collateral on these financial instruments.

We maintain cash and cash equivalents in excess of federally insured limits, principally with financial institutions located in the U.S. Risk on accounts receivable is reduced by the number of entities comprising our member firm base and through ongoing evaluation of collectability of amounts owed to us. We use outside investment managers to manage our investment portfolio and a custody agent, a publicly traded company headquartered in New York, to hold our fixed income and certain equity investments.

We maintain a broadly diversified investment portfolio, representing a wide range of assets and asset classes, in order to attain acceptable levels of risk and return. Our investment portfolio consists of investments in predominantly investment grade debt securities, mutual and commingled funds containing equity securities and other investments.

The Company attempts to minimize credit risk by monitoring the creditworthiness of the financial institutions with which it transacts business.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

RECENT ACCOUNTING PRONOUNCEMENTS

*New accounting pronouncements adopted in 2020*

FINRA adopted the following accounting pronouncements on January 1, 2020, with no material effect on our consolidated financial statements:

- Accounting Standards Update (ASU) 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*; effective for FINRA in 2020.

*New accounting pronouncements adopted in 2019*

On January 1, 2019, we adopted ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* and ASU 2016-01, *Financial Instruments—Recognition and Measurement of Financial Assets and Financial Liabilities*. Prior year financial statements were not restated. A summary of the effects of the initial adoption of ASU 2014-09 and ASU 2016-01 follows.

| | ASU 2014-09 | ASU 2016-01 | Total |
|---|---|---|---|
| | | *(in millions)* | |
| Increase (decrease): | | | |
| Liabilities (deferred revenue) | $(20.7) | $ — | $(20.7) |
| Accumulated other comprehensive income | — | 0.6 | 0.6 |
| Equity | 20.7 | (0.6) | 20.1 |

We adopted ASU 2014-09 on a modified retrospective basis as of January 1, 2019. Under this method of adoption, we recorded a cumulative-effect adjustment that increased the beginning balance of equity by $20.7 million on January 1, 2019, and changed the presentation of certain revenues prospectively. The cumulative-effect adjustment represents the release of previously deferred initial registration fees that no longer qualify for deferral under the ASU.

With respect to ASU 2016-01, beginning in 2019, unrealized gains and losses from the changes in the fair value of our equity securities during the period are included within net realized and unrealized investment gains in the consolidated statements of operations. Prior to January 1, 2019, we recognized gains and losses in earnings when we sold equity securities and for other-than-temporary impairment losses and we recorded unrealized gains and losses from the changes in fair value of such securities in other comprehensive loss. As of January 1, 2019, we reclassified net unrealized losses on equity securities from accumulated other comprehensive loss to equity.

On January 1, 2019, FINRA adopted the following accounting pronouncements, with no material effect on our consolidated financial statements:

- ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*
- ASU 2016-16, *Income Taxes (Topic 710): Intra-Entity Transfers of Assets Other Than Inventory*
- ASU 2017-06, *Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): Employee Benefit Plan Master Trust Reporting (a consensus of the Emerging Issues Task Force)*
- ASU 2017-07, *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*

*New accounting pronouncements to be adopted subsequent to December 31, 2020*

In August 2018, the Financial Accounting Standards Board (FASB) issued ASU 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans*. The ASU makes minor changes to the disclosure requirements for employers that sponsor defined

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

benefit pension and/or other postretirement benefit plans, eliminating requirements for certain disclosures that are no longer considered cost beneficial and requiring new disclosures considered to be pertinent. The effective date for FINRA is January 1, 2021. We do not expect the adoption of the ASU to have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. The ASU requires lessees to put most leases on their balance sheets but recognize expenses on their statements of operations in a manner similar to today's accounting. The ASU also eliminates today's real estate-specific provisions for all entities. For lessors, the ASU modifies the classification criteria and the accounting for sales-type and direct financing leases. Since the issuance of the ASU, various updates and amendments have been issued including a second deferral of the effective date for entities that are not public business entities. The current effective date for FINRA is January 1, 2022. Early adoption is permitted; however, we do not intend to early adopt the ASU. We are currently completing a diagnostic assessment of the ASU based on our current inventory of leases. We are planning to elect the additional transition option, which allows entities to not apply the new leases standard in the comparative period they present in their financial statements in the year of adoption. We are currently assessing the impact that the ASU will have on our consolidated financial statements.

In July 2016, the FASB issued the final guidance on credit losses, ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which will significantly change how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. Entities will be required to use a new forward-looking "expected loss" model and record an allowance that, when deducted from the amortized cost basis of the financial asset, presents the net amount expected to be collected on the financial asset. This approach will apply to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans, held-to-maturity debt securities, net investments in leases and off-balance-sheet credit exposures. The ASU will also require significantly more disclosures to be made in an entity's financial statements. Since the issuance of the ASU, various updates and amendments have been issued, including a deferral of the effective date by one year for entities that are not public business entities. The current effective date for FINRA is January 1, 2023. Early adoption is permitted; however, we do not intend to early adopt the ASU. We are currently assessing the potential impact that the ASU will have on our consolidated financial statements.

**3. REVENUE FROM CONTRACTS WITH CUSTOMERS**

We recognize revenue when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration that we expect to receive in exchange for those goods or services. We generate all of our revenue from contracts with customers.

*Disaggregation of revenue*

The following table provides a summary of revenues by contract for the years ended December 31, 2020 and 2019, all of which is recognized over time.

| | Years ended December 31, | |
|---|---|---|
| | 2020 | 2019 |
| | *(in millions)* | |
| FINRA rules and by-laws | $ 942.8 | $777.9 |
| Regulatory agreements | 168.2 | 114.1 |
| Mortgage licensing system maintenance agreement | 13.3 | 7.8 |
| Testing services agreements | 13.0 | 11.6 |
| All other contracts | 25.3 | 27.1 |
| Net revenue | $1,162.6 | $938.5 |

**3. REVENUE FROM CONTRACTS WITH CUSTOMERS (CONTINUED)**

Our revenues are generally recognized over time as we perform services. We measure our progress in completing these services based upon the passage of time. This method faithfully depicts our performance of transferring control of the services to the customer as our customers simultaneously receive and consume the benefits provided by our performance.

The following is a description of our contracts with customers.

*FINRA rules and by-laws*

FINRA's rules and by-laws form the contract between FINRA and its members. Under this contract, we provide the following services to our members: i) oversight services; ii) member application, associated person registration and qualification services; and iii) transparency services. Oversight services include surveillance; member and market examinations; enforcement and disciplinary procedures; fraud detection; dispute resolution; and rulemaking and policies. Member application, associated person registration and qualification services include broker-dealer firm member applications; associated person and branch office registrations; and qualification exams and continuing education. Transparency services include the management and operation of FINRA's OTC market transparency facilities, such as TRACE and ORF, which provide the public and professionals with timely market information for debt and equity securities. Revenues related to FINRA's rules and by-laws are included in regulatory, fines and user revenues in our consolidated statements of operations.

Consideration is due as the services are rendered. Consideration for services provided in accordance with our rules and by-laws is variable, taking into account provisions for adjustments, refunds, rebates, fee waivers and penalties for late filings. Our estimate of variable consideration is not typically constrained, as the effects of such variable consideration are known to us prior to the release of our consolidated financial statements.

*Regulatory agreements*

We have various regulatory agreements through which we provide regulatory services, such as surveillance reviews, investigations, examinations and disciplinary functions. Pursuant to a contract with Consolidated Audit Trail, LLC, we are also responsible for all aspects of the build, maintenance and operation of the CAT, including recurring operations and production milestones, cloud hosting, and customer account and database services. Revenues related to our regulatory agreements are included in contract services revenues in our consolidated statements of operations. Consideration is due as services are rendered. Consideration for services provided in accordance with our regulatory agreements is variable, taking into account provisions for cost of living adjustments, changes in the scope of services and changes in trading volumes. Our estimate of variable consideration related to our provision of regulatory services is not typically constrained, as the effects of such variable consideration are known to us prior to the release of our consolidated financial statements. Our estimate of variable consideration related to our CAT responsibilities is typically constrained by the amount of future milestone payments. We are required to update our estimate of variable consideration, including any constrained amounts, at the end of each reporting period to reflect our revised expectations of the amount of consideration to which we expect to be entitled.

*Mortgage licensing system maintenance agreement*

We have a maintenance agreement related to the mortgage licensing system FINRA developed for SRR. Under this contract, we provide hardware maintenance and software development and maintenance services. Revenues related to the system maintenance agreement are recorded in contract services revenues in our consolidated statements of operations. Consideration is due as services are rendered. Consideration for services provided in accordance with our system maintenance agreement is variable, taking into account the role of the person performing the maintenance (such as a business analyst, developer, tester or project manager, for example), the hourly rate for each role, and the number of

**3. REVENUE FROM CONTRACTS WITH CUSTOMERS (CONTINUED)**

hours worked. Our estimate of variable consideration is not typically constrained, as the effects of such variable consideration are known to us prior to the release of our consolidated financial statements.

*Testing services agreements*

We have testing services agreements for the benefit of investment advisers and mortgage brokers. Under these contracts, we provide testing registration, maintenance and delivery of qualification examinations. Revenues related to our testing services agreements are recorded in user and contract services revenues in our consolidated statements of operations. Consideration is due as services are rendered. Consideration for services provided in accordance with our testing services agreements is variable, taking into account provisions for base exam fees plus adjustments for the cancellation, no-show and rescheduling of exams. Our estimate of variable consideration is not typically constrained, as the effects of such variable consideration are known to us prior to the release of our consolidated financial statements.

*All other contracts*

All other contracts primarily include contracts related to our administration of the Investment Adviser Registration Depository program, and provision of OTC data to the Nasdaq Unlisted Trading Privileges (UTP) plan. Consideration for these services is variable and due as services are rendered. Our estimate of variable consideration is not typically constrained, as the effects of such variable consideration are known to us prior to the release of our consolidated financial statements.

*Contract balances*

The following table provides information about receivables and contract liabilities from contracts with customers as of December 31, 2020 and 2019:

| | As of December 31, | |
|---|---|---|
| | 2020 | 2019 |
| | *(in millions)* | |
| Receivables, net | $216.6 | $129.4 |
| Current deferred revenue | 58.8 | 60.2 |

See Note 2, "*Receivables, Net*" for additional information about our receivables balances.

### 3. REVENUE FROM CONTRACTS WITH CUSTOMERS (CONTINUED)

Deferred revenue for the years ended December 31, 2020 and 2019 primarily consists of prepayments of registration and renewal fees, annual assessments, and arbitration and mediation fees under FINRA's rules and by-laws. The revenue recognized from contract liabilities and the remaining balance is shown below:

| | January 1, 2020 | Additions (1) | Revenue recognition | December 31, 2020 |
|---|---|---|---|---|
| | | *(in millions)* | | |
| Registration and renewal (2) | $55.7 | $ 69.9 | $ (70.4) | $55.2 |
| Assessments (3) | — | 303.7 | (303.7) | — |
| Arbitration and mediation (4) | 4.5 | 6.8 | (7.7) | 3.6 |
| Total deferred revenue | $60.2 | $380.4 | $(381.8) | $58.8 |

| | January 1, 2019 | Cumulative effect of change in accounting principle (5) | Additions (1) | Revenue recognition | December 31, 2019 |
|---|---|---|---|---|---|
| Registration and renewal (2) | $74.8 | $(20.7) | $ 73.1 | $ (71.5) | $55.7 |
| Assessments (3) | — | — | 269.3 | (269.3) | — |
| Arbitration and mediation (4) | 5.0 | — | 8.1 | (8.6) | 4.5 |
| Total deferred revenue | $79.8 | $(20.7) | $350.5 | $(349.4) | $60.2 |

(1) Additions reflect fees charged during the period.

(2) Fees are assessed for initial registrations, membership applications and renewals of FINRA member firms, registered representatives, principals and branch offices primarily to cover web CRD system processing. These registration and renewal fees are amortized and recorded ratably over the annual period to which they apply.

(3) Annually, each FINRA member is charged assessments based on: 1) their gross income; and 2) the member's number of registered representatives and principals. These fees support the supervision and regulation of firms through examination, policy making, rulemaking and enforcement activities performed each year. These fees are amortized and recorded ratably over the annual period to which they apply.

(4) Arbitration and mediation filings and arbitration member surcharges provide a material right, access to FINRA's arbitration and mediation forums. As such, these fees are amortized and recorded over the period of benefit of the fee. We have determined the period of benefit to be the average turnaround time for an arbitration case (14 months) or mediation case (four months).

(5) The cumulative-effect adjustment represents the release of previously deferred initial registration fees that no longer qualify for deferral under ASU 2014-09.

### 4. INVESTMENTS

FINRA owns a diverse investment portfolio consisting of 1) U.S. government (and state and local) securities; 2) mortgage-backed securities; 3) corporate and asset-backed securities; 4) mutual and commingled funds; 5) other investments (including pooled investment funds); and 6) other financial instruments. Our investment policy strives to preserve principal, in real terms, while seeking to earn a long-term rate of return commensurate with the degree of risk deemed appropriate by the Board. We execute our investment strategy through a separately managed account and direct investments. FINRA's investment portfolio consisted of the following as of:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| | *(in millions)* | |
| Fixed income investments | $ 538.1 | $ 617.5 |
| Equity investments | 621.7 | 356.9 |
| Other investments: | | |
| Investments of Consolidated Entity | 238.9 | 217.3 |
| Pooled investment funds | 171.1 | 451.0 |
| Other | 0.3 | 0.3 |
| Total other investments | 410.3 | 668.6 |
| Total | $1,570.1 | $1,643.0 |

FIXED INCOME INVESTMENTS

We classified our fixed income investments as trading based on their nature, and our intent and ability to sell or to hold the securities. Our fixed income portfolio was managed by an investment manager, who had the authority to buy and sell investments within FINRA-determined, pre-established parameters. Our fixed income investments, summarized based on the primary industry of the issuers, are disclosed in Note 5, "Fair Value Measurement."

EQUITY INVESTMENTS

FINRA's equity investments consisted of the following:

| | Cost | Net unrealized gain | Fair value |
|---|---|---|---|
| | | *(in millions)* | |
| As of December 31, 2020: | | | |
| Mutual funds | $128.5 | $41.0 | $169.5 |
| Commingled funds | 400.9 | 51.3 | 452.2 |
| Total | $529.4 | $92.3 | $621.7 |
| As of December 31, 2019: | | | |
| Mutual funds | $145.8 | $35.8 | $181.6 |
| Commingled funds | 151.7 | 23.6 | 175.3 |
| Total | $297.5 | $59.4 | $356.9 |

**4. INVESTMENTS (CONTINUED)**

OTHER INVESTMENTS

As of December 31, 2020 and 2019, our other investments consisted of investments of the Consolidated Entity and pooled investment funds for which the fair value option has been elected.

*Consolidated Entity and Investments of the Consolidated Entity*

FINRA holds a 100 percent equity interest in the Consolidated Entity, and the general partner of the Consolidated Entity is fully independent of FINRA management and its Board. The objective of the Consolidated Entity is to maximize risk-adjusted returns over the long-term horizon through potential investment in a wide array of investments and strategies. The following table summarizes 2020 and 2019 activity related to the Consolidated Entity.

| | Consolidated Entity |
|---|---|
| | *(in millions)* |
| Balance, January 1, 2019 | $ 326.8 |
| Investment gains | 29.0 |
| Contributions | 11.0 |
| Redemptions | (148.1) |
| Balance, December 31, 2019 | 218.7 |
| Investment gains | 22.8 |
| Contributions | 4.0 |
| Distributions | (9.0) |
| Balance, December 31, 2020 | $ 236.5 |

As of December 31, 2020 and 2019, the carrying value of the net assets and liabilities of the Consolidated Entity was $236.5 million and $218.7 million, which represented its maximum risk of loss as of those dates. During 2020, the carrying value of the net assets and liabilities of the Consolidated Entity increased by $17.8 million, resulting from $22.8 million of investment gains and $4 million of contributions, net of $9 million in distributions. During 2019, the carrying value of the net assets and liabilities of the Consolidated Entity decreased $108.1 million, resulting from $148.1 million in redemptions, net of investment gains of $29 million and contributions of $11 million. The assets of the Consolidated Entity primarily consisted of cash and investments, while the liabilities primarily represented accrued expenses of the Consolidated Entity. The assets of the Consolidated Entity may be used only to settle obligations of the Consolidated Entity. In addition, there is no recourse to the Company for the Consolidated Entity's liabilities.

**4. INVESTMENTS (CONTINUED)**

Investments held by the Consolidated Entity, summarized below, primarily consist of limited partnerships managed by the investment manager of the Consolidated Entity, as well as hedge funds, private equity funds or similar investment vehicles managed by external managers directly or through subsidiary funds that are controlled by the investment manager of the Consolidated Entity. These investments are included in other investments in the accompanying consolidated balance sheets. The Consolidated Entity's net assets consist primarily of its investments accounted for at fair value; the majority of the Consolidated Entity's fair value measurements are based on the estimates made by the general partner of the Consolidated Entity. The investment strategy of these limited partnerships is multi-strategy.

| | Fair value as of December 31, 2020 | Fair value as a percentage of investments of Consolidated Entity as of December 31, 2020 |
|---|---|---|
| | *(in millions)* | |
| Investments of Consolidated Entity | | |
| North America | | |
| HighVista Master Fund LP | $117.0 | 49.0% |
| Other | 121.9 | 51.0% |
| Total investments (cost $211.1 million) | $238.9 | 100.0% |

As of December 31, 2020, no underlying investment held by these limited partnerships had a fair value that exceeded 5 percent of FINRA's total consolidated equity.

*Pooled Investment Funds*

FINRA invests in pooled investment funds for which the fair value option was elected. As of December 31, 2020, FINRA held one pooled investment fund with a carrying value of $171.1 million included in other investments in the consolidated balance sheets. As of December 31, 2019, FINRA held four pooled investment funds with a carrying value of $451 million included in other investments in the consolidated balance sheets. During the years ended December 31, 2020 and 2019, we made contributions of $72.7 million and $153.5 million, respectively, to these investment funds. During the years ended December 31, 2020 and 2019, we made redemptions of $266.4 and $37.5 million, respectively, from these investment funds. No interest and dividends were recorded during 2020 and 2019.

**4. INVESTMENTS (CONTINUED)**

INVESTMENT GAINS AND LOSSES

Investment gains and losses for each of the two years ending December 31, 2020, are summarized below:

| | Fixed income investments | Equity investments | Pooled investment funds | Investments of Consolidated Entity | Total |
|---|---|---|---|---|---|
| | | *(in millions)* | | | |
| For the year ending December 31, 2020 | | | | | |
| Unrealized investment gains on securities held at the end of the period | $11.7 | $32.9 | $ 9.2 | $18.8 | $ 72.6 |
| Investment gains (losses) on securities sold during the period | 9.2 | 9.8 | (95.4) | 6.3 | (70.1) |
| Other gains | — | 1.4 | — | — | 1.4 |
| Total | $20.9 | $44.1 | $(86.2) | $25.1 | $ 3.9 |
| For the year ending December 31, 2019 | | | | | |
| Unrealized investment gains (losses) on securities held at the end of the period | $22.3 | $58.2 | $(32.7) | $23.8 | $ 71.6 |
| Investment (losses) gains on securities sold during the period | (2.9) | 16.4 | (5.6) | 7.6 | 15.5 |
| Other gains | — | 3.8 | — | — | 3.8 |
| Total | $19.4 | $78.4 | $(38.3) | $31.4 | $ 90.9 |

Realized and unrealized gains and losses on our investments, including investments of the Consolidated Entity, are included in net realized and unrealized gains in the consolidated statements of operations. Unrealized gains or losses result from changes in the fair value of these investments. Upon disposition of an investment, unrealized gains or losses are reversed and an offsetting realized gain or loss is recognized in the period the disposition occurs.

**5. FAIR VALUE MEASUREMENT**

The Company considers cash and cash equivalents, our investment portfolio, receivables, investments receivable and investments payable to be its financial instruments. The carrying amounts reported in the consolidated balance sheets for these financial instruments equal or closely approximate fair value.

U.S. GAAP defines fair value as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date (*i.e.*, an exit price).

U.S. GAAP prioritizes the level of market price observability used in measuring assets and liabilities at fair value. There are a number of factors that impact market price observability, including the type of assets and liabilities, and the specific characteristics of the assets and liabilities. Assets and liabilities with prices that are readily available, actively quoted or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and less degree of judgment used in measuring fair value.

Assets and liabilities measured at fair value are classified into one of the following categories:

- Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity has the ability to access as of the measurement date.
- Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, through corroboration with observable data.
- Level 3 Unobservable inputs, such as internally developed pricing models for the asset or liability due to little or no market activity for the asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an asset or liability's level within the fair value hierarchy is based on the lowest level input that is significant to the fair value measurement. The assessment of significance of a particular input to the fair value measurement in its entirety requires judgment and factors specific to the asset or liability.

### 5. FAIR VALUE MEASUREMENT (CONTINUED)

The following table presents information about our assets that are measured at fair value on a recurring basis as of December 31, 2020, and indicates the fair value hierarchy of the valuation techniques used to determine fair value:

| | | Fair Value Measurement at December 31, 2020 Measured Using | |
|---|---|---|---|
| Description | Total carrying amount in consolidated balance sheet December 31, 2020 | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) |
| | | *(in millions)* | |
| Assets: | | | |
| Fixed income investments | | | |
| Corporate debt securities | | | |
| Banking | $ 85.9 | $ — | $ 85.9 |
| Industrial | 87.8 | — | 87.8 |
| Financial institution | 45.3 | — | 45.3 |
| Consumer non-cyclical | 40.0 | — | 40.0 |
| Utility | 37.8 | — | 37.8 |
| Collateralized mortgage obligations | 97.9 | — | 97.9 |
| Agency mortgage-backed securities | | | |
| Conventional | 46.7 | — | 46.7 |
| Other | 22.3 | — | 22.3 |
| Government securities | 48.3 | 13.7 | 34.6 |
| Other securitized securities | 26.1 | — | 26.1 |
| Equity investments | | | |
| Mutual funds | | | |
| U.S. equity | 115.2 | 115.2 | — |
| Other | 54.2 | 54.2 | — |
| Commingled funds | | | |
| U.S. fixed income | 239.6 | — | 239.6 |
| International equity | 147.1 | — | 147.1 |
| U.S. equity | 65.6 | — | 65.6 |
| Total assets in the fair value hierarchy | 1,159.8 | 183.1 | 976.7 |
| Pooled investment funds, measured at net asset value (a) (b) | 171.1 | — | — |
| Investments of Consolidated Entity (a) (c) | 238.9 | — | — |
| Total assets measured at fair value | $1,569.8 | $183.1 | $976.7 |

**5. FAIR VALUE MEASUREMENT (CONTINUED)**

The following table presents information about our assets that are measured at fair value on a recurring basis as of December 31, 2019, and indicates the fair value hierarchy of the valuation techniques used to determine fair value:

| | | Fair Value Measurement at December 31, 2019 Measured Using | |
|---|---|---|---|
| Description | Total carrying amount in consolidated balance sheet December 31, 2019 | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) |
| | | *(in millions)* | |
| Assets: | | | |
| Fixed income investments | | | |
| Corporate debt securities | | | |
| Banking | $ 105.9 | $ — | $ 105.9 |
| Industrial | 91.1 | — | 91.1 |
| Consumer non-cyclical | 44.3 | — | 44.3 |
| Other financial institutions | 37.7 | — | 37.7 |
| Utility | 35.1 | — | 35.1 |
| Collateralized mortgage obligations | 112.6 | — | 112.6 |
| Agency mortgage-backed securities | | | |
| FHLMC | 53.2 | — | 53.2 |
| Other | 39.6 | — | 39.6 |
| Government securities | 55.1 | — | 55.1 |
| Asset-backed securities | 42.9 | — | 42.9 |
| Equity investments | | | |
| Mutual funds | | | |
| U.S. equity | 130.0 | 130.0 | — |
| Other | 51.6 | 51.6 | — |
| Commingled funds | | | |
| International equity | 99.9 | — | 99.9 |
| U.S. equity | 44.9 | — | 44.9 |
| U.S. fixed income | 30.5 | — | 30.5 |
| Total assets in the fair value hierarchy | 974.4 | 181.6 | 792.8 |
| Pooled investment funds, measured at net asset value (a) (b) | 451.0 | — | — |
| Investments of Consolidated Entity (a) (c) | 217.3 | — | — |
| Total assets measured at fair value | $1,642.7 | $181.6 | $ 792.8 |

(a) In accordance with ASC Subtopic 820-10, certain investments that are measured at fair value using the net asset value per share practical expedient have not been classified in the fair value hierarchy. The fair value amount presented in this table is intended to permit reconciliation of the fair value hierarchy to the fair value of assets presented in the consolidated balance sheets.

(b) The Company invests in pooled investment funds for which the fair value option has been elected. These investments are offshore feeder funds in a “master-feeder” structure, and substantially all of their capital is invested in their respective master funds. The master funds’ investment objectives include producing risk-

**5. FAIR VALUE MEASUREMENT (CONTINUED)**

adjusted returns while maintaining low correlation to traditional markets by taking long and short positions in major equities, fixed income, currencies and commodities markets offering a high level of liquidity, as well as investments in other pooled investment vehicles. These investments generally have a redemption notice period between three to 95 days, and shares may be redeemed on a semimonthly, monthly, or semiannually (June 30 and December 31) basis. We do not have any outstanding capital commitments related to these investments. As of December 31, 2020, FINRA held one pooled investment fund.

(c) The investments of the Consolidated Entity consist of limited partnerships managed by the investment manager of the Consolidated Entity as well as hedge funds, private equity funds or similar investment vehicles. These investments generally employ a diversified investment strategy. The fair value of the investments of the Consolidated Entity is measured at net asset value on the balance sheet date. The investment manager of the Consolidated Entity has a valuation committee consisting of its key officers and select members of the investment operations team for the investment manager. The valuation committee reviews and approves valuations for all investments for which the third-party administrator is unable to obtain a price independently. The Consolidated Entity had unfunded commitments through its investment in limited partnerships of $59.1 million and $55.8 million as of December 31, 2020 and 2019, respectively. Capital calls will be funded with available cash held by the Consolidated Entity or by liquidating investments of the Consolidated Entity, as needed. The underlying investments held by these limited partnerships may be subject to various levels of liquidity restrictions.

As of December 31, 2020 and 2019, we had no investments categorized in Level 3 of the fair value hierarchy.

Changes in the fair value of our fixed income, equity and other investments measured at net asset value are recorded as a component of net realized and unrealized investment gains in the consolidated statements of operations.

The following is a description of the valuation methodologies used for financial assets measured at fair value on a recurring basis and the general classification of these instruments pursuant to the fair value hierarchy.

*Fixed Income*

All of our fixed income investments are priced using the services of third-party pricing vendors; however, pricing for some of the U.S. Government securities are publicly available. These vendors use evaluated and industry-accepted pricing models that vary by asset class and incorporate market inputs such as available trade, bid and other market information to determine the fair value of the securities. Accordingly, the valuation of these investments is categorized in Levels 1 and 2 of the fair value hierarchy.

We independently validate the fair value measurement of our fixed income investments to determine that the assigned fair values are appropriate. To validate pricing information received, our policy is to employ a variety of procedures throughout the year, including comparing information received to other pricing sources and performing independent price checks.

*Mutual Funds*

Some of our mutual funds—which consist of funds invested in domestic bonds, domestic and international equities, and a life-cycle fund focused on asset allocation through investments in other mutual funds, primarily in bonds with the remainder in equities—relate to our deferred compensation plan for officers, our supplemental defined contribution plan for senior officers and our closed defined benefit SERP obligation. Additionally, we have a domestic mutual fund that invests in high-quality companies that have both the ability and the commitment to grow their dividends over time.

**5. FAIR VALUE MEASUREMENT (CONTINUED)**

These investments are valued at the publicly quoted net asset value per share, which is computed as of the close of business on the balance sheet date. Accordingly, the valuation of these investments is categorized in Level 1 of the fair value hierarchy.

*Commingled Funds*

Our commingled funds employ a variety of strategies, including domestic and international equities, and domestic fixed income securities.

These investments are valued at the quoted net asset value per unit, computed as of the close of business on the balance sheet date. Units of these investments are valued daily and a unit-holder's ability to transact in the funds' units occurs daily; however, units are not traded on an active exchange. As the fair value per unit is readily determinable, the valuation of these investments is categorized in Level 2 of the fair value hierarchy.

**6. INCOME TAXES**

FINRA and FINRA REG are tax-exempt organizations under IRC Section 501(c)(6). The Foundation is a tax-exempt organization under IRC Section 501(c)(4). FINRA CAT is treated as a disregarded entity for federal income tax purposes in accordance with single member limited liability company rules.

*Unrelated Business Income*

Unrelated business income activities are taxed at normal corporate rates to the extent that they have taxable net income. Our unrelated business activities consist primarily of mortgage licensing services provided under our contract with SRR, certain external client exams and other consulting services.

NASD Holding, Inc. (NAHO), a wholly owned taxable subsidiary of FINRA prior to its liquidation in 2005, had net operating losses (NOLs) to which FINRA, as the parent organization, succeeded. The related deferred tax asset resulting from the transfer of the NAHO NOLs to FINRA was measured at $20.5 million based on federal tax rates then in effect, and FINRA recorded a valuation allowance equal to that amount. Aside from the NAHO NOLs, FINRA's deferred tax asset is primarily composed of losses related to other contractual work performed in the past. The deferred tax asset, which remains entirely reserved, is remeasured each period at rates expected to be in effect in the future period that the asset is used. As of December 31, 2020 and 2019, FINRA's deferred tax asset was $7.6 million and $8.7 million, respectively, based on federal unrelated business loss carryforwards of $36.4 million and $41.5 million, respectively, which are scheduled to expire beginning in 2023 through 2028.

The following table summarizes the 2020 and 2019 activity related to the federal deferred tax asset and valuation allowance:

| | Deferred tax asset—NOLs | Valuation allowance | Net deferred tax assets |
|---|---|---|---|
| | | *(in millions)* | |
| Deferred tax asset, January 1, 2019 | $10.4 | $(10.4) | $— |
| 2019 federal provision | (1.7) | 1.7 | — |
| Deferred tax asset, December 31, 2019 | 8.7 | (8.7) | — |
| 2020 federal provision | (1.1) | 1.1 | — |
| Deferred tax asset, December 31, 2020 | $ 7.6 | $ (7.6) | $— |

**6. INCOME TAXES (CONTINUED)**

There were no other significant deferred tax assets related to unrelated business income. The 2020 and 2019 income tax provision of $1.5 million and $2.5 million, respectively, primarily represented the net change in deferred tax assets related to unrelated business loss carryforwards during the year in addition to state income tax and other minor adjustments. The income tax provision was included in other expense in the consolidated statements of operations.

We did not have any significant unrelated business income taxes payable in 2020 or 2019.

*Uncertain Tax Positions*

U.S. GAAP provides a two-step approach for evaluating tax positions. Recognition (step 1) occurs when an entity concludes that a tax position, based solely on its technical merits, is more likely than not to be sustained upon examination. Measurement (step 2) occurs when the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis, that is more likely than not to be realized upon ultimate settlement. From 2017 through 2020, the years management considers to be open for examination by taxing authorities, management did not identify the existence of any uncertain tax positions related to current operations. Additionally, FINRA has not recognized any material uncertain tax positions related to the succession to the NAHO NOLs.

**7. EMPLOYEE BENEFIT LIABILITIES**

BENEFIT PLANS

The following table summarizes the benefit plans FINRA offers.

| Plan | Eligible employees |
|---|---|
| Defined benefit ERP | Fewer than 600 current employees not previously transitioned out of the plan (closed to new participants) |
| Defined benefit SERP | Three current senior executives not previously phased out of the plan in 2011 (closed to new participants) |
| Retiree medical plan | Eligible active employees, retirees and their dependents |
| Postretirement life insurance benefit plan | 100 retirees who opted into the plan (closed to new participants) |
| Voluntary contributory savings plan | All active employees |
| Defined contribution component of the savings plan | Active employees not participating in the defined benefit ERP |
| Deferred compensation plan for officers | Active officer-level employees (vice president and above) |
| Supplemental defined contribution plan for senior officers | Active senior executives not participating in the defined benefit SERP |

A brief description of the plans follows.

*Defined Benefit ERP and SERP*

We provide two non-contributory defined benefit pension plans to eligible employees, including a qualified ERP and a non-qualified SERP. The benefits are based primarily on years of service and employees' average compensation during the highest 60 consecutive months of employment. Both plans are now closed to new participants. The benefits of those participants who previously transitioned out of the ERP were frozen at the time of transition and will be made available to them upon retirement.

**7. EMPLOYEE BENEFIT LIABILITIES (CONTINUED)**

*Retiree Medical Plan*

The Company maintains the Retiree Medical Plan to provide health benefits to eligible retired employees and their eligible dependents. Eligible retirees pay the full premium cost to be enrolled in the Company's retiree medical coverage. Under the Retiree Medical Plan, the Company offers a Retiree Medical Savings Plan that provides eligible retirees with credits retirees can use to help pay for health care premiums during retirement. Included in the Retiree Medical Plan are Retiree Medical Accounts created for eligible employees and retirees with fixed annual credits applied to those accounts for each year of FINRA service beginning at age 40, and accrual of credits for a portion of the active employee's unused vacation and personal leave. Employees can access the credits only in retirement and may use the credits only toward paying a portion of monthly premiums under FINRA-sponsored retiree health plans.

*Postretirement Life Insurance Benefit Plan*

The Company provides a non-contributory specified life insurance benefit to eligible retired employees. The postretirement life insurance benefit plan is closed with respect to new participants.

*Voluntary Contributory Savings Plan*

FINRA maintains a voluntary contributory savings plan for eligible employees. Employees are immediately eligible to make elective contributions to the plan up to specified plan limits. Employees are also eligible to receive from FINRA a corresponding dollar-for-dollar matching contribution on any elective contribution made by the participant to the savings plan up to a maximum of 6 percent of base compensation.

The savings plan expense for 2020 and 2019 was $28.4 million and $24.9 million, respectively, which was included within compensation and benefits expense in the consolidated statements of operations.

*Defined Contribution Component of the Savings Plan*

FINRA offers a defined contribution component of the savings plan to all eligible employees not currently participating in the ERP.

The Company's contributions for this component are based on a participant's age plus years of service, and vesting is on a graduated scale over six years. The investment options are the same as the current options in the savings plan. Expenses related to the defined contribution component of the savings plan for 2020 and 2019 were $27.4 million and $24.6 million, respectively, which were included within compensation and benefits expense in the consolidated statements of operations.

*Deferred Compensation Plan for Officers*

FINRA maintains a deferred compensation plan for officers under the provisions of Section 457(b) of the IRC. Eligible employees may contribute to the plan and, at its discretion, FINRA may make additional contributions to the plan. FINRA placed the assets of this plan into an irrevocable rabbi trust that the Company consolidates. As of December 31, 2020, $29.3 million of investments and $29.3 million of amounts due to plan participants were included in equity investments and accrued personnel and benefit costs in the consolidated balance sheet, representing participant contributions to this plan and accrued earnings. As of December 31, 2019, $25.2 million of investments and $25.2 million of amounts due to plan participants were included in equity investments and accrued personnel and benefit costs in the consolidated balance sheet, representing participant contributions to this plan and accrued earnings. As of December 31, 2020 and 2019, FINRA made no additional contributions to this plan.

**7. EMPLOYEE BENEFIT LIABILITIES (CONTINUED)**

*Supplemental Defined Contribution Plan for Senior Officers*

FINRA maintains a supplemental defined contribution plan for the Company's senior officers and makes annual contributions based on salary and a portion of incentive compensation. Contributions and earnings vest upon the earlier of 1) the end of each third year of participation following such contribution; 2) attainment of age 62; 3) death; or 4) a disabled participant's termination of employment. FINRA placed the assets of this plan into an irrevocable rabbi trust that the Company consolidates. As of December 31, 2020, $22.6 million of investments and $22.6 million of amounts due to plan participants were included in equity investments and accrued personnel and benefit costs in the consolidated balance sheet, representing FINRA's contributions to this plan and accrued earnings. As of December 31, 2019, $20.3 million of investments and $20.3 million of amounts due to plan participants were included in equity investments and accrued personnel and benefit costs in the consolidated balance sheet, representing FINRA's contributions to this plan and accrued earnings.

*Voluntary Retirement Program*

On September 18, 2019, FINRA announced the implementation of a one-time Voluntary Retirement Program (VRP). The VRP was designed for those employees who were retirement-eligible (minimum age of 55) and when combined with years of service, reached a minimum combined age/years of service of 65 as of December 31, 2019. The VRP included provisions for benefits in the form of severance payments; medical, dental and vision benefits; outplacement services; and eligibility and payout for various bonus programs, as applicable.

We followed the accounting guidance related to special termination benefits provided under the VRP. As of December 31, 2019, we have accrued $33.6 million of severance benefits related to the VRP and this amount was included in compensation and benefits expense in the consolidated statements of operations. In 2020, $18.5 million of severance benefits were paid out to VRP participants.

Curtailments, settlements and special termination benefits with respect to pension and retiree medical benefits under the VRP are included in the plan disclosures below.

**7. EMPLOYEE BENEFIT LIABILITIES (CONTINUED)**

PLAN DISCLOSURES

The following tables disclose information related to our "Pension Plans," which include the ERP and SERP described above, and "Other Plans," which include the retiree medical and postretirement life insurance benefit plans described above. The reconciliation of the projected benefit obligation, the change in the fair value of plan assets for the periods ended December 31, 2020 and 2019, and the accumulated benefit obligation at December 31, 2020 and 2019, were as follows:

| | Pension Plans | | Other Plans | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| | (in millions) | | | |
| **Change in benefit obligation** | | | | |
| Benefit obligation at beginning of period | $ 729.4 | $ 571.7 | $ 83.6 | $ 77.1 |
| Service cost | 13.0 | 14.6 | 3.5 | 3.4 |
| Interest cost | 20.6 | 23.8 | 2.6 | 3.3 |
| Actuarial losses (gains) | 93.8 | 127.1 | 10.1 | 1.8 |
| Benefits paid | (81.6) | (17.8) | (2.1) | (2.1) |
| Curtailment loss | — | 10.0 | — | — |
| Special termination benefits | — | — | — | 0.1 |
| Benefit obligation at end of period | $ 775.2 | $ 729.4 | $ 97.7 | $ 83.6 |
| **Change in plan assets** | | | | |
| Fair value of plan assets at beginning of period | $ 591.1 | $ 492.5 | $ — | $ — |
| Actual return on plan assets | 94.7 | 116.4 | — | — |
| Company contributions | 7.0 | — | 2.1 | 2.1 |
| Benefits paid | (81.6) | (17.8) | (2.1) | (2.1) |
| Fair value of plan assets at end of period | $ 611.2 | $ 591.1 | $ — | $ — |
| Underfunded status of the plan | $(164.0) | $(138.3) | $(97.7) | $(83.6) |
| Accumulated benefit obligation | $ 710.2 | $ 680.5 | | |

Our total accrued pension and other postretirement liability in the consolidated balance sheets comprised the following:

| | Pension Plans | | Other Plans | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| | (in millions) | | | |
| Current | $ 1.7 | $ 10.7 | $ 2.5 | $ 2.2 |
| Noncurrent | 162.3 | 127.6 | 95.2 | 81.4 |
| Net amount at December 31 | $164.0 | $138.3 | $97.7 | $83.6 |

There are no plan assets for the SERP, retiree medical and postretirement life insurance benefit plans. The current portion of SERP and other liabilities represented the net present actuarial value of benefits to be paid over the next 12 months in excess of plan assets and was included in accrued personnel and benefit costs in the consolidated balance sheet.

The Company does not expect any plan assets to be returned to it during the year ending December 31, 2021.

**7. EMPLOYEE BENEFIT LIABILITIES (CONTINUED)**

The components of net periodic benefit cost included in the consolidated statements of operations were as follows:

| | Pension Plans | | Other Plans | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| | *(in millions)* | | | |
| Service cost | $ 13.0 | $ 14.6 | $3.5 | $3.4 |
| Interest cost | 20.6 | 23.8 | 2.6 | 3.3 |
| Expected return on plan assets | (33.4) | (29.2) | — | — |
| Recognized net actuarial losses | 7.1 | 1.7 | — | — |
| Prior service cost recognized | — | — | 1.4 | 1.4 |
| Curtailment expense | — | 10.0 | — | — |
| Settlement expense | 14.9 | — | — | — |
| Special termination benefits | — | — | — | 0.1 |
| Net periodic benefit cost | $ 22.2 | $ 20.9 | $7.5 | $8.2 |

Service cost was included in compensation and benefits expense in the consolidated statements of operations. All other components of net periodic benefit cost were included in other expense in the consolidated statements of operations.

The assumed health care cost trend rate we will use for the next year to measure the expected cost of other plan liabilities is 6.8 percent, with a gradual decline to 5.9 percent by the year 2025. This estimated trend rate is subject to change. The assumed health care cost trend rate can have a significant effect on the amounts reported. However, a 1-percentage-point change in the assumed health care cost trend rate would not have a material impact on the benefit obligation or service and interest components of net periodic benefit cost.

The net amounts included in accumulated other comprehensive loss were as follows:

| | Pension Plans | | Other Plans | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| | *(in millions)* | | | |
| Unrecognized net actuarial loss | $(122.8) | $(112.3) | $(16.1) | $(6.0) |
| Unrecognized prior service cost | — | — | (0.6) | (2.0) |
| Net amount at December 31 | $(122.8) | $(112.3) | $(16.7) | $(8.0) |

The following amounts were included in other comprehensive loss during 2020:

| | Incurred but not yet recognized in net periodic benefit cost | Reclassification adjustment for prior period amounts recognized |
|---|---|---|
| | *(in millions)* | |
| **Actuarial (losses) gains** | | |
| Pension plans | $(17.6) | $7.1 |
| Other plans | (10.1) | — |
| | (27.7) | 7.1 |
| **Prior service cost** | | |
| Pension plans | — | — |
| Other plans | — | 1.4 |
| | — | 1.4 |
| | $(27.7) | $8.5 |

**7. EMPLOYEE BENEFIT LIABILITIES (CONTINUED)**

The estimated amounts to be amortized from accumulated other comprehensive loss into net periodic benefit cost during 2021 based on December 31, 2020, plan measurements were as follows:

| | Pension Plans | Other Plans |
|---|---|---|
| | *(in millions)* | |
| Unrecognized prior service costs | $ — | $0.6 |
| Unrecognized actuarial losses | 4.5 | 0.4 |

The weighted-average assumptions used to determine benefit obligations for the years ended December 31, 2020 and 2019, were as follows:

| | Pension Plans | | Other Plans | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| Discount rate | 2.48% | 3.17% | 2.33% | 3.07% |
| Rate of compensation increase | 3.00% | 3.00% | — | — |

The weighted-average assumptions used to determine net periodic benefit cost for the years were as follows:

| | Pension Plans | | Other Plans | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| Discount rate | 3.17% | 4.27% | 3.07% | 4.14% |
| Rate of compensation increase | 3.00% | 3.00% | — | — |
| Expected return on plan assets | 6.10% | 6.10% | — | — |

The assumptions above are used to develop the benefit obligations at year end and to develop the net periodic benefit cost for the subsequent year. Therefore, the assumptions used to determine benefit obligations are established at each year end while the assumptions used to determine net periodic benefit cost for each year are established at the end of each previous year. The expected return on plan assets that will be used in the determination of 2021 net periodic benefit cost is 5.25 percent.

The benefit obligations and the net periodic benefit cost are based on actuarial assumptions that are reviewed on an annual basis. We revise these assumptions based on an annual evaluation of long-term trends, as well as market conditions, which may have an impact on the cost of providing retirement benefits.

## PLAN ASSETS

We fund our ERP obligation, and we have established an irrevocable rabbi trust to fund our SERP obligation. The retiree medical and postretirement life insurance benefit plans are unfunded plans.

The trust related to the SERP obligation is included in our consolidated financial statements. As of December 31, 2020 and 2019, $0.8 million and $5 million of investments were included in equity securities in the consolidated balance sheets, representing the amounts contributed by FINRA, plus earned income and market value gains, less distributions to retirees and market value losses. Additionally, as of December 31, 2020, $1.2 million of investments is included in cash and cash equivalents in the consolidated balance sheet, representing pending distributions to participants.

The investment policy and strategy of the ERP assets are established by the Pension Committee, which is composed of a cross-representative body of FINRA officers assisted by outside counsel, investment advisors and actuaries. The Management Compensation and Investment Committees of the Board have oversight responsibilities with respect to the ERP and its assets. The investment policy and strategy strive to achieve a rate of return on plan assets that will, over the long term, in concert with Company contributions, fund the plan’s liabilities to provide for required benefits. As the funded

**7. EMPLOYEE BENEFIT LIABILITIES (CONTINUED)**

status of the plan improves, the plan will assume less risk through reductions in return-seeking exposure and/or improved matching of fixed income assets with liabilities.

The ERP assets are allocated among a diversified portfolio of equity investments, fixed income securities, alternative investments and cash equivalents with both domestic and international strategies. Derivatives are permitted on a limited scale for hedging or creation of market exposures. Direct debt and equity interests are prohibited in any broker-dealer, exchange, contract market, regulatory client, alternative or electronic trading system or entity that derives a certain threshold of revenue from broker-dealer activities. Asset allocations are reviewed quarterly and adjusted, as appropriate, to remain within target allocations. The Pension Committee reviews the investment policy annually, under the guidance of an investment consultant, to determine whether a change in the policy or asset allocation targets is necessary.

The ERP assets consisted of the following as of December 31, 2020 and 2019:

| | 2020 Target Allocation | 2020 | 2019 |
|---|---|---|---|
| Equity securities: | | | |
| U.S. equity | 15.9% | 16.5% | 16.5% |
| Non-U.S. equity | 14.1% | 15.0% | 14.9% |
| Global equity | 20.3% | 21.0% | 21.3% |
| U.S. fixed income securities | 46.0% | 44.3% | 44.1% |
| Alternative investments | 2.7% | 2.3% | 2.4% |
| Cash equivalents | 1.0% | 0.9% | 0.8% |
| Total | 100.0% | 100.0% | 100.0% |

The expected long-term rate of return for the plan's total assets is based on the expected returns of each of the above categories, weighted based on the current target allocation for each class. At least annually, the Pension Committee evaluates whether adjustments are needed based on historical returns to more accurately reflect expectations of future returns.

**7. EMPLOYEE BENEFIT LIABILITIES (CONTINUED)**

The following tables present information about the fair value of the Company's ERP assets at December 31, 2020 and 2019, by asset category, and indicate the fair value hierarchy of the valuation techniques used to determine fair value:

| Description | Fair Value Measurement at December 31, 2020 Measured Using | | |
|---|---|---|---|
| | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Total |
| | | *(in millions)* | |
| Cash and cash equivalents | $ 7.3 | $ — | $ 7.3 |
| U.S. Government securities | 4.9 | — | 4.9 |
| Corporate debt instruments | — | 5.5 | 5.5 |
| Corporate stocks | 18.0 | — | 18.0 |
| Common/collective trusts (a): | | | |
| Equity | — | 282.9 | 282.9 |
| Fixed income | — | 165.4 | 165.4 |
| Registered investment companies: | | | |
| Equity | 19.1 | — | 19.1 |
| Fixed income (b) | 13.0 | 98.3 | 111.3 |
| Other | — | 0.6 | 0.6 |
| Total assets in the fair value hierarchy | 62.3 | 552.7 | 615.0 |
| Partnership/joint venture interests measured at net asset value (c): | — | — | 1.0 |
| Payables, net (1) | — | — | (4.8) |
| Total | $62.3 | $552.7 | $611.2 |

(1) Represents pending trades at December 31, 2020.

| Description | Fair Value Measurement at December 31, 2019 Measured Using | | |
|---|---|---|---|
| | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Total |
| | | *(in millions)* | |
| Money market funds | $ 4.7 | $ — | $ 4.7 |
| Corporate stocks | 13.7 | — | 13.7 |
| Common/collective trusts (a): | | | |
| Equity | — | 241.2 | 241.2 |
| Fixed income | — | 158.6 | 158.6 |
| Registered investment companies: | | | |
| Equity | 56.7 | — | 56.7 |
| Fixed income | 115.0 | — | 115.0 |
| Total assets in the fair value hierarchy | 190.1 | 399.8 | 589.9 |
| Partnership/joint venture interests measured at net asset value (c): | — | — | 1.2 |
| Total | $190.1 | $399.8 | $591.1 |

**7. EMPLOYEE BENEFIT LIABILITIES (CONTINUED)**

(a) Includes both domestic and international equity and fixed income securities. Fair values are readily available and have been estimated using the net asset value per unit of the funds. Investment managers are not constrained by any particular investment style and may invest in either “growth” or “value” securities. Units of these investments are valued daily and a unit-holder’s ability to transact in the trusts’ units occurs daily; however, units are not available on an active exchange. As the fair value per unit is readily determinable, the valuation of these securities is categorized in Level 2 of the fair value hierarchy.

(b) Includes domestic fixed income securities. Fair values are readily available and have been estimated using the net asset value per share of the funds. Investments included in this category include registered investment companies that are publicly traded and private placement securities. Investment objectives primarily seek maximum total returns. Shares of these investments are valued and transacted daily; however, shares through private placement are not available on an active exchange. As the fair value per share is readily determinable, the valuation of these securities is categorized in Level 1 and Level 2 of the fair value hierarchy.

(c) In accordance with ASC Subtopic 820-10, a certain investment that is measured at fair value using the net asset value per share practical expedient has not been classified in the fair value hierarchy. The fair value amount presented in this table is intended to permit reconciliation of the fair value hierarchy to the fair value of plan assets presented in the plan disclosures section of this footnote.

The investment included in this category is a private equity fund that invests in the natural resources and real estate industries. The investment is nonredeemable. The fair value of the investment has been estimated using the net asset value per share of the investment.

For the years ended December 31, 2020 and 2019, there were no transfers between Level 1, Level 2 or Level 3 of the fair value hierarchy.

The valuation techniques and inputs used to measure fair value of the ERP assets are consistent with the Company’s valuation procedures as disclosed in Note 5, “Fair Value Measurement.” For alternative investments, net asset value is used as a practical expedient to measure fair value unless it is probable that an investment will be sold for a different amount. In these cases, fair value is measured based on recent observable transaction information for similar investments, the consideration of non-binding bids from potential buyers and third-party valuations.

## EXPECTED FUTURE BENEFIT PAYMENTS

We measure our plans as of the end of each fiscal year. The ERP’s funding policy is to fund at least 100 percent of the ERP’s funding target liability as set forth by the Internal Revenue Service. In 2021, we expect to contribute $36.6 million to the ERP. We do not expect to contribute to the SERP in 2021. In addition, we expect to make the following benefit payments to participants over the next 10 years:

| | Pension Plans | Other Plans |
|---|---|---|
| | *(in millions)* | |
| Year ending December 31, | | |
| 2021 | $ 35.6 | $ 5.0 |
| 2022 | 28.2 | 9.4 |
| 2023 | 31.0 | 9.6 |
| 2024 | 37.1 | 10.0 |
| 2025 | 41.1 | 10.9 |
| 2026 through 2030 | 207.6 | 65.8 |
| Total | $380.6 | $110.7 |

**8. ACCUMULATED OTHER COMPREHENSIVE LOSS**

The following is a summary of changes in accumulated other comprehensive loss as of December 31, 2020 and 2019.

| | Unrealized gain (loss) on available-for-sale investments | Net unrecognized employee benefit plan amounts | Total |
|---|---|---|---|
| | | *(in millions)* | |
| Balance, January 1, 2019 | $(0.6) | $ (81.6) | $ (82.2) |
| Cumulative effect from change in accounting policy (a) | 0.6 | — | 0.6 |
| Other comprehensive loss before reclassifications | — | (41.8) | (41.8) |
| Amounts reclassified from accumulated other comprehensive loss (b) | — | 3.1 | 3.1 |
| Net current-period other comprehensive loss | 0.6 | (38.7) | (38.1) |
| Balance, December 31, 2019 | — | (120.3) | (120.3) |
| Other comprehensive loss before reclassifications | — | (27.7) | (27.7) |
| Amounts reclassified from accumulated other comprehensive loss (b) | — | 8.5 | 8.5 |
| Net current-period other comprehensive loss | — | (19.2) | (19.2) |
| Balance, December 31, 2020 | $ — | $(139.5) | $(139.5) |

(a) Effective January 1, 2019, we adopted ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*—see Note 2, "Summary of Significant Accounting Policies," for more information.

(b) Reclassified net unrecognized employee benefit plan amounts were included as a component of net periodic benefit cost and recorded in other expense in the consolidated statements of operations—see Note 7, "Employee Benefit Liabilities," for additional information.

**9. LEASES**

FINRA leases certain office space and equipment in connection with its operations. The majority of these leases contain escalation clauses based on increases in rent, property taxes and building operating costs. Certain of these leases also contain renewal options. Rent expense for operating leases was $34.3 million and $26.7 million for the years ended December 31, 2020 and 2019, which was included in occupancy expense in the consolidated statements of operations.

Future minimum lease payments under non-cancelable operating leases with initial or remaining terms of one year or more consisted of the following at December 31, 2020:

| Year ending December 31, | *(in millions)* |
|---|---|
| 2021 | $ 21.2 |
| 2022 | 24.2 |
| 2023 | 22.9 |
| 2024 | 21.8 |
| 2025 | 19.4 |
| Remaining years | 95.1 |
| Total minimum lease payments | $ 204.6 |

## 10. DEBT

FINRA maintains an unsecured line of credit agreement and has the option to borrow up to $100 million at the LIBOR Daily Floating Rate plus 0.55 percent (0.63 percent at December 31, 2020). As of December 31, 2020 and 2019, no line of credit amounts were outstanding. Our latest line of credit renewal commenced on March 1, 2021 and expired on May 31, 2021.

As of December 31, 2020 and 2019, we had outstanding debt of $12.8 million and $13.7 million, respectively, on our unsecured 2.99 percent fixed rate seven-year term loan related to our 2015 purchase of the Omega Building in Rockville, Maryland.

## 11. COMMITMENTS AND CONTINGENCIES

*General Litigation*

Management is not aware of any unasserted claims or assessments that would have a material adverse effect on the Company's financial position and the results of operations. Currently, there are certain legal proceedings pending against us. While the outcome of any pending litigation cannot be predicted, management does not believe that any such matter will have a material adverse effect on our business or financial position. As of December 31, 2020, there were no material estimated losses requiring disclosure related to pending legal proceedings, because we believe that any litigation contingency from these matters involves a chance of loss that is either remote or not reasonably possible. Such pending legal matters involve unspecified claim amounts, in which the respective plaintiffs seek an indeterminate amount of damages. The outcome of such matters is always uncertain, and unforeseen results can occur. It is possible that such outcomes could require us to pay damages or make other expenditures or establish accruals in amounts that we could not estimate as of December 31, 2020.

*Indemnities*

The general partner and investment manager of the Consolidated Entity, on behalf of the Consolidated Entity, enter into certain contracts that contain a variety of indemnifications. The Consolidated Entity's maximum exposure under these arrangements is unknown. However, the Consolidated Entity has not had prior claims or losses pursuant to these contracts and expects any risk of loss to be remote.

## 12. SUBSEQUENT EVENTS

Subsequent events have been evaluated through June 25, 2021, the date these financial statements became available to be issued. These financial statements have been approved by management, who has determined that no subsequent event occurred that would require disclosure in the consolidated financial statements or accompanying notes.

# FINRA Board of Governors as of June 1, 2021

**Eileen K. Murray (Public)**
Chairperson
Former Co-CEO, Bridgewater Associates, LP
Westport, CT

**Robert W. Cook**
President and CEO
FINRA
Washington, DC

**Deborah Bailey (Public)**
Retired
San Francisco, CA

**Camille M. Busette (Public)**
Brookings Institution
Washington, DC

**Lance F. Drummond (Public)**
Retired
Charlotte, NC

**Jack B. Ehnes (Public)**
CalSTRS
West Sacramento, CA

**Peter R. Fisher (Public)**
Tuck School of Business, Dartmouth College
Hanover, NH

**Christopher W. Flint (Industry)**
Farmers Financial Solutions LLC
Bellevue, WA

**Maureen Jensen (Public)**
Former Chair and Chief Executive Officer, Ontario Securities Commission
Toronto, Ontario Canada

**Brian J. Kovack (Industry)**
Kovack Securities, Inc.
Ft. Lauderdale, FL

**Wendy Lanton (Industry)**
Herold & Lantern Investments, Inc.
Melville, NY

**Kathleen A. Murphy (Industry)**
Fidelity Personal Investing
Boston, MA

**Linde Murphy (Industry)**
M.E. Allison & Co., Inc.
San Antonio, Texas

**James D. Nagengast (Industry)**
Securities America, Inc.
LaVista, NE

**Eric Noll (Public)**
Context Capital Partners
Bala Cynwyd, PA

**Paige W. Pierce (Industry)**
Bley Investments Group, Inc.
Fort Worth, TX

**Charles I. Plosser (Public)**
Former President and CEO, Federal Reserve Bank of Philadelphia
Amelia Island, FL

**Kathryn Ruemmler (Industry)**
Goldman Sachs & Co., LLC
New York, NY

**Hillary A. Sale (Public)**
Georgetown University Law Center
Washington, DC

**Timothy C. Scheve (Industry)**
Janney Montgomery Scott LLC
Philadelphia, PA

**Ethiopis Tafara (Public)**
Multilateral Investment Guarantee Agency, World Bank Group
Washington, DC

**Amy L. Webber (Industry)**
Cambridge Investment Research, Inc.
Fairfield, IA

# FINRA Officers as of June 1, 2021

**Robert W. Cook**
President and Chief Executive Officer

**Marcia E. Asquith**
Executive Vice President, Board and External Relations

**Richard W. Berry**
Executive Vice President and Director of FINRA Dispute Resolution Services

**Robert L.D. Colby**
Executive Vice President and Chief Legal Officer

**Gene DeMaio**
Executive Vice President, TFCE and Options Regulation

**Todd T. Diganci**
Executive Vice President, Chief Financial and Administrative Officer

**Stephanie Dumont**
Executive Vice President, Market Regulation and Transparency Services

**Bari Havlik**
Executive Vice President, Member Supervision

**Jessica Hopper**
Executive Vice President and Head of Enforcement

**Jon Kroeper**
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