

“What to Expect” Series

Preparing for a FINRA Cycle Examination

In this edition of our “What to Expect” series on FINRA’s regulatory processes, we focus on what your firm can expect during a FINRA cycle examination. We understand that the arrival of FINRA examiners at your firm may cause some anxiety—especially if it’s your first examination, or if it has been a while since your last one. We hope you find this information helpful and that it takes some of the mystery out of FINRA’s examination process.

Exam Timing: Why My Firm?

FINRA conducts between 1,500 and 2,000 risk-based cycle examinations each year to assess identified risks and controls and determine whether firms are in compliance with federal securities laws, rules and regulations. Each year, FINRA assesses your firm’s business activities, the risks associated with those activities and any factors that may influence or otherwise impact FINRA’s assessment of risk to determine whether your firm’s cycle examinations will be conducted on a one, two, three or four-year cycle. While it’s possible that your firm’s cycle may change from one year to the next, your firm will receive a cycle examination at least once every four years.

At the time your firm is due for examination, your Regulatory Coordinator, working with the examination team, will build a risk-based execution strategy that focuses on risks in areas that are material to your firm’s business, as well as areas that are deemed regulatory priorities. Additionally, your firm’s cycle examinations may also include reviews for compliance with MSRB rules, and rules of the various other exchanges for which FINRA conducts regulatory work.

The Exam Process

Preparation and Execution Component

Your firm’s assigned Regulatory Coordinator and/or the Lead Examiner on the cycle examination will notify your firm of an upcoming exam up to 60 days before the on-site component begins. During the call the staff will provide high-level details regarding the logistics of the examination, provide a sense of the risk areas being considered for review, if known, and indicate when your firm can expect to receive the first document request. In the period before the on-site component begins, FINRA staff reviews and analyzes your firm’s information to gain a more fulsome understanding of your firm’s business and to better pinpoint the material risks and priority areas that should be included in the examination strategy. While the staff will interact with your firm during this period, and possibly request meetings, this work for the most part is conducted on FINRA premises.

During this phase of the examination, and throughout the examination process, FINRA will make requests for documents via Request Manager, which is an application accessible to your firm via FINRA Firm Gateway. Request Manager streamlines the document request and production process, and creates an audit trail of requests and productions that benefit both FINRA and your firm during the course of the examination. The staff can provide you with detailed information through Request Manager at any point during the examination.



On-site Component

When the examiners arrive at your office to begin the on-site portion of the examination, they will have a good sense as to the examination strategy and will be positioned to make more specific and granular requests for information around these prioritized areas of review. Again, Request Manager is the vehicle through which these requests are made and fulfilled. The staff will typically request a tour of your firm’s offices, as well as request meetings with the business and compliance leads at your firm. These meetings are extremely helpful in the staff’s assessment of risk and controls and often provide insight to the staff that cannot be articulated in a response to a documentation request.

The interaction between the examination team and your firm is integral to an efficient examination. During these meetings you may also have an opportunity to meet FINRA’s Examination and Surveillance management team who often joins the staff on-site to supervise the examination and interact with the firm. During the course of the examination, one examiner will serve as the primary point of contact for your firm. However, to the extent someone from your firm wishes to speak to an Exam Manager or Exam Director, he or she should not hesitate to do so. Together, these are the people who will ensure that there is effective communication between FINRA and your firm throughout the course of the examination. For example, if a certain document request can be met through alternative, more efficient means, your firm should discuss this with the examination team. Also be sure to discuss any other questions regarding the progress of the examination. We find that an agreed upon timeframe for status meetings (*e.g.*, every Friday), while not required, is extremely helpful in ensuring that both FINRA staff and your firm are on the same page as to outstanding requests and overall progress of the examination. These meetings are good opportunities for your firm to learn of possible exceptions and determine whether corrective action can be taken before the conclusion of the examination. Depending on the type of exception, if your firm can demonstrate swift corrective action, it may not appear in the final Examination Report.

Once the onsite reviews are substantially complete, the examination team will conduct an Exit Meeting with your firm to discuss the areas of review and preliminary exceptions and/or recommendations. The staff will prepare and provide your firm with an Exit Meeting Report before the meeting. This allows your firm and the exam team to discuss, among other things, your firm’s preliminary response for each potential exception. To the extent your firm believes it has documentation or other evidence to address any particular exception that may not have been provided to the examination team, your firm can provide that information at the Exit Meeting, or shortly thereafter, for the staff to review and assess before the examination is completed and closed.

Closeout Component

After the Exit Meeting, the examination team will prepare an Examination Report for FINRA management to review and approve. It includes a summary of the risk areas that were reviewed during the course of the examination, and the detailed exceptions and recommendations, if applicable. Once approved, FINRA sends the Examination Report to your firm’s CEO along with a cover letter. If no exceptions are found, the exam will be considered complete. If exceptions are found, your firm will be required to submit a formal written response to FINRA that identifies the corrective action the firm has either taken, or plans to take. If FINRA finds the response to be adequate, the firm will next receive a Disposition Letter that outlines the treatment of each exception in terms of No Further Action,

Cautionary Action or Referral to Enforcement. No Further Action and Cautionary Action are considered to be informal dispositions and are not reportable on Forms U4 or BD. If the response is inadequate, FINRA will continue to discuss the response with your firm and will ultimately send a Disposition Letter outlining the findings and any outstanding areas for firm action.

Resolving Differences

At times, differences may come up between examiners and firms. If your firm encounters such a problem, you can always talk with your examiner about any questions or comments you may have. But understand that FINRA exam staff perform a critical regulatory and investor protection function and must make the final call on the timing, topics and scope of a particular exam. If you have a difference that you cannot resolve directly with the examiner, contact the Exam Manager or Exam/Associate Director.

Benefits of an Exam

A FINRA exam is an excellent opportunity to take a thorough look at the risks impacting your business and the controls put in place to mitigate those risks. Most exceptions found during cycle exams are resolved through an informal disposition. This means that your firm can fix problem areas and improve procedures and internal controls without any disciplinary action or reportable event placed on its record. Remember that repeat violations of even minor exceptions are taken seriously and may result in a formal disciplinary action. So, when exceptions are noted, update your firm’s Written Supervisory Procedures and take any corrective action needed to make sure problem areas are addressed and do not recur. Many firms view an exam as an opportunity to educate employees on compliance and supervision, and to clarify the distinction between these two functions. Concerns related to registered representative activity, such as sales practice issues, that surface during an exam should be addressed in your Continuing Education Needs Analysis and incorporated into your Firm Element Training Plan.

Resources:

Annual Regulatory and Examination Priorities Letters

<http://www.finra.org/Industry/Regulation/Guidance/CommunicationstoFirms/P122861>

Compliance Tools and Checklists

<http://www.finra.org/Industry/Tools/>