## Common Examination Findings
## Thursday, October 24, 2019
## 10:15 a.m. – 11:15 a.m.

Join FINRA staff as they discuss FINRA's examination process and most common deficiencies identified during cycle examinations of small firms. Industry practitioners present effective practices for preparing for examinations, taking corrective action and updating compliance procedures, and practices based on lessons learned from common examination findings.

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Associate District Director, Sales Practice
FINRA Denver District Office

**Speakers:** Alif Dhanidina
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**Common Examination Findings Panelist Bios:**

Moderator:

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Speakers:

**Alif Dhanidina** is Principal Regulatory Coordinator in the Los Angeles District Office of FINRA. Mr. Dhanidina's responsibilities include conducting risk assessments of member firms, planning firm examinations, and conducting firm examinations. Prior to joining FINRA, Mr. Dhanidina spent seven years as a Senior Counsel in the SEC Office of Compliance Inspections and Examinations in Washington DC. Previous to the SEC, Mr. Dhanidina was employed by the Illinois Securities Department as an Enforcement Attorney.

**Shawn P. McLaughlin, AIF®** has more than 35 years of investment experience and specializes in helping individuals, businesses and associations achieve their investment goals through careful and thorough financial planning. Mr. McLaughlin began his career with a major regional brokerage firm where he spent 20 years building his practice. He started his own firm 16 years ago and has owned his broker-dealer for nine years. Mr. McLaughlin holds an Accredited Investment Fiduciary™ (AIF®) designation. He earned his Bachelor of Science in Business Administration from Georgetown University and remains active as a mentor to students in Georgetown's business school. Mr. McLaughlin has been active in Northern Virginia business and civic communities for decades. He served on the Inova Health System Board of Trustees and is a past chairman of the Inova Foundation. Mr. McLaughlin served as Chairman of the Board of Trustees of the Virginia College Savings Plan (VCSP) from 2010 through 2017. Currently, Mr. McLaughlin serves on the Board of Visitors of the School of Business at Marymount University in Arlington, Virginia and the Board of Directors of Burke & Herbert Bank, as well as FINRA's Small Firm Advisory Committee. Additionally, Mr. McLaughlin serves as a member of the Board of Directors of Georgetown Visitation Preparatory School and is chairman of the Investment Committee. He is also chairman of the Finance Council of the Basilica of St. Mary Parish. Mr. McLaughlin holds Series 7, 9 and 10, 24, 63 and 65 licenses along with his Virginia Life, Health, and Variable Life annuity insurance licenses.

**Harry Striplin** is Chief Compliance Officer for Umpqua Investments, Inc., a small firm headquartered in Portland, Oregon. He has been with Umpqua Investments for nine years. Mr. Striplin has more than 36 years of experience working at small firms and more than 27 years serving as a Chief Compliance Officer in the small firm environment. He has served as a member of FINRA's District 3 Committee, the Securities Industry Regulatory Council on Continuing Education and has been a panelist at FINRA securities conferences. Mr. Striplin has been a member of the Securities Industry Continuing Education Content Committee for more than 20 years. Mr. Striplin serves as an arbitrator for FINRA Dispute Resolutions and has achieved his Certified Regulatory and Compliance Professional™ (CRCP™) certification through the FINRA Institute at Wharton.

 



# Common Examination Findings

# Panelists

- **Moderator**
  - Gerald Dougherty, Associate District Director, Sales Practice, FINRA Denver District Office
- **Panelists**
  - Alif Dhanidina, Principal Regulatory Coordinator, Sales Practice, FINRA Los Angeles District Office
  - Shawn McLaughlin, President and Chief Executive Officer, McLaughlin Ryder Investments, Inc.
  - Harry Striplin, Chief Compliance Officer, Paulson Investment Company, LLC

FINRA

# 2019 Report on FINRA Examination Findings and Observations


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## INTRODUCTION

In both 2017 and 2018, FINRA issued Reports on Examination Findings in response to firms' requests that we make publicly available a summary of key findings from FINRA's examinations of member firms. Firms use this information, as well as effective practices observed by FINRA at certain firms, to anticipate potential areas of concern and improve their procedures and controls. (We subsequently refer to the two prior years' documents as the "2017 Report" and the "2018 Report.")

The name of this year's report—the "2019 Report on Examination Findings and Observations"—reflects FINRA's recent decision to distinguish more clearly between examination findings and observations. Findings constitute a determination that a firm or registered person has violated U.S. Securities and Exchange Commission (SEC), FINRA or other relevant rules. By contrast, observations (formerly known as recommendations) are suggestions to a firm about how it could improve its control environment in order to address perceived weaknesses that elevate risk, but do not typically rise to the level of a rule violation or cannot be tied to an existing rule, and are communicated to firms separately from the formal examination report. This report reflects key findings and observations identified in recent examinations, and contains effective practices, where noted, that could help firms improve their compliance and risk management programs. Where a matter is rule-based, the applicable regulatory sources ("Regulatory Obligations") are identified under the topic heading.

As a reminder, this report does not represent a complete inventory of findings, observations or effective practices. In fact, an individual firm may not have any deficiencies identified in this report, or may have other deficiencies that were not included. Similarly, we recognize that firms may employ effective practices that are not described in this report.

Further, this report does not create new legal or regulatory requirements or new interpretations of existing requirements. There should be no inference that FINRA requires firms to implement any specific effective practices described in this report or those that extend beyond the requirements of existing securities rules and regulations.

FINRA always welcomes feedback on how we can improve the content, structure, format or other elements of future reports on examination findings and observations. If you have suggestions, please contact Steven Polansky, Senior Director, Member Supervision, at (202) 728-8331 or by email, or Elena Schlickenmaier, Principal Research Analyst, Member Supervision, at (202) 728-6920 or by email.

# Supervision

## Regulatory Obligations

FINRA Rule 3110 (Supervision) requires firms to establish, maintain and enforce a system to supervise their activities and the activities of their associated persons that is reasonably designed to achieve compliance with federal securities laws and regulations, as well as FINRA rules. This includes updating supervisory processes and written supervisory procedures (WSPs) to address new or amended rules, as well as products and services.

Customer account and trading supervision includes complying with other obligations, such as FINRA Rule 4512 (Customer Account Information), which specifies the categories of customer account information firms must maintain. Further, FINRA Rule 2231 (Customer Account Statements) generally requires firms to send customers account statements containing their securities positions, money balances and account activity at least once each calendar quarter. Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 (Exchange Act), as well as the FINRA Rule Series 4510 (Books and Records Requirements) prescribe recordkeeping obligations relating to customer account records, trading records and related documentation.

## Noteworthy Examination Findings

FINRA noted the following issues relating to supervision and documentation requirements.

- **Insufficient WSPs for New or Amended Rules –** Some firms did not adequately address newly adopted or amended rules by developing controls to address the new requirements applicable to their business and updating their WSPs accordingly, for example: new fixed income mark-up disclosure requirements under FINRA Rule 2232 (Customer Confirmations); new trusted contact person information requirements pursuant to Rule 4512 (Customer Account Information); temporary holds, supervision and record retention requirements under new Rule 2165 (Financial Exploitation of Specified Adults) (if they intended to use the rule); and compliance with amended Rule 3310 (Anti-Money Laundering Compliance Program), which incorporates FinCen's new Customer Due Diligence (CDD) rule obligations. Firms are expected to evaluate which new and amended laws and regulations apply to their business, and review whether their supervisory systems, WSPs and training programs need to be amended to comply with any new or amended requirement(s).
- **Limited Supervision and Internal Inspections –** Some firms did not have reasonably designed branch supervision and inspection programs. In particular, some firms did not adequately understand the activities being conducted through their branch offices, including products and services that were offered only at certain branch locations, which could prevent such firms from effectively supervising and addressing the unique risks of each branch location. Many firms also did not conduct periodic inspections of non-branch locations as required by FINRA Rule 3110(c) (Internal Inspections); did not determine relevant areas of review at branch offices or non-branch locations, taking into consideration the nature and complexity of the products and services offered or any indicators of irregularities or misconduct; failed to reduce the inspections and reviews to a written report; or did not follow through on corrective action determined to be necessary through their branch inspections.
- **Inadequate Supervision of Account Statements, Consolidated Account Reports and Other Forms –** FINRA found that some firms did not consistently maintain accurate information in account documents, which impacted their ability to reasonably supervise account activity.
  - *Consolidated Account Reports (CARs)*[1] – In certain instances, firms did not have supervisory systems to evaluate whether and when registered representatives used CARs, did not know

when CARs included manual entries by representatives or customers, and did not require review of relevant customer documents to confirm that CARs accurately represented customers' assets and values that were held outside the broker-dealer. FINRA notes that firms with stronger supervisory systems maintained comprehensive WSPs and training addressing the use and supervision of CARs; had strict limits on the use of CARs, including around manual entries; and determined whether they accurately reflected customer holdings outside of the broker-dealer.

- *Falsifying Documents* – Some firms did not have reasonable processes to detect or prevent various forms of forgeries, including "accommodation forgery," where registered representatives and associated persons asked customers to sign blank, partial or incomplete documents. Some firms expanded risk-based reviews of associated persons' communications to cover requests for customer signatures or enhanced firm reviews of customer complaints for issues relating to forgery or falsification of documents. In addition, some firms did not follow their protocols relating to notarization and medallion stamp guarantees, or did not have any supervisory procedures for supervising the use of such stamps.

- **Insufficient Supervision for Specific Types of Accounts –** FINRA noted the following supervisory issues.
  - *Restricted and Insider Accounts* – Some firms failed to update timely their watch and restricted lists, or reasonably identify and restrict account activity susceptible to insider trading. Other firms did not have surveillance systems or procedures to review and approve restricted trading because they relied on clearing firms to conduct the review. Both introducing and correspondent firms are required to have supervisory systems reasonably designed to detect and prevent insider trading.
  - *Margin Accounts* – Some firms allowed customers to open margin accounts even though the customers did not meet the firms' standards for such accounts. FINRA also identified that some firms' systems of supervision were not reasonably designed to detect recommended margin account activity that appeared to be unsuitable and inconsistent with the cost and expense of margin use. Many firms' supervisory systems could not identify situations where the firm failed to accurately disclose their own—as well as their clearing firms'—fees, costs and charges relating to customers' use of margin.
  - *Options Accounts* – FINRA noted instances where some firms did not identify or prevent registered representatives from creating and canceling fictitious orders to circumvent sales limits; mismarking opening options transactions as "closing"; listing inaccurate receipt time, execution time and origin codes on tickets; failing to record purchases and time of order transmission for routed options orders in the firms' order management systems; and failing to show the terms or conditions of the order on tickets.

## Additional Resources

- *Regulatory Notice 10-19* (FINRA Reminds Firms of Responsibilities When Providing Customers with Consolidated Financial Account Reports)
- New Account Application Template
- Supervision Topic Page
- Books and Records Topic Page
- Broker-Dealer – Written Supervisory Procedures Checklist
- Supervision category of the Peer-2-Peer Compliance Library
- Customer Information category of the Peer-2-Peer Compliance Library

## Suitability[2]

### Regulatory Obligations

Currently, FINRA's suitability rule establishes obligations that are central to promoting ethical sales practices and high standards of professional conduct. FINRA Rule 2111 (Suitability) establishes three primary obligations for firms and their associated persons: (1) reasonable-basis suitability, (2) customer-specific suitability and (3) quantitative suitability.[3]

### Noteworthy Examination Findings

Some firms did not have adequate systems of supervision to review that recommendations were suitable in light of a customer's individual financial situation and needs, investment experience, risk tolerance, time horizon, investment objectives, liquidity needs and other investment profile factors. This report shares some new suitability-related findings, as well as additional nuances on prior years' findings.

- **Inadequate Supervision of Product Exchanges –** Some firms did not maintain a supervisory system reasonably designed to assess the suitability of recommendations that customers exchange certain products, such as mutual funds, variable annuities or unit investment trusts (UITs). In particular, some firms did not maintain blotters or other processes to identify patterns of unsuitable recommendations of exchanges involving long-term products.[4] Additionally, some firms did not reasonably supervise exchanges because they could not verify the information provided by registered representatives in their rationales to justify a recommended exchange, such as inaccurate descriptions of product fees, costs and existing product values. In other instances, firm supervision did not detect that the source of funds for a purchase was misrepresented (*i.e.*, as "new" money), when other account information revealed another likely source of funds (*e.g.*, funds from a liquidation of another financial product at the firm).
- **Limited Supervision to Identify "Red Flags" for Suitability –** Some firms' supervisory systems were not reasonably designed or used to detect red flags of possible unsuitable transactions. For example, some firms did not identify or question patterns of similar recommendations by representatives or branch offices across many customers with different risk profiles, time horizons and investment objectives. In some instances, several customers of a representative or branch office appeared to have made "unsolicited" transactions in identical securities, which could raise questions around whether the transactions were actually "unsolicited."
- **Inadequate Supervision of Changes to Customer Account Information –** As discussed further in the Supervision section of this report, FINRA noted instances where registered representatives unilaterally changed account information, such as customers' income, net worth or account objectives. In many instances, the changes preceded or were contemporaneous with one or more transactions that, but for the account change, would have been subject to heightened supervisory scrutiny, raised suitability concerns or would not have been approved.
- **Limited Supervision of Trading Activity for Excessive Trading or Churning –** FINRA identified a variety of situations where supervisors failed to recognize when a pattern of transactions rendered the series of recommendations unsuitable. FINRA also noted that some firms did not adequately train supervisors how to use exception reports to identify red flags indicative of excessive trading. In other cases, some firms did not appropriately respond to and address red flags indicating excessive trading identified through their exception reports.[5]

- **Unsuitable Options Strategy Recommendations –** FINRA identified registered representatives recommending complex options strategies to customers who did not have the sophistication to understand the features of an option or the associated strategy, or without adequately considering the customers' individual financial situations and needs, as well as other investment profile factors. Further, some firms did not implement trade limits and controls to identify and prevent options trading that exceeded customer pre-approved investment levels.

### Additional Resources

- 2017 Report – Product Suitability
- 2018 Report – Suitability for Retail Customers
- *Regulatory Notice 18-13* (FINRA Requests Comment on Proposed Amendments to the Quantitative Suitability Obligation Under FINRA Rule 2111)
- Supervision Topic Page
- Suitability Topic Page
- Customer Information category of the Peer-2-Peer Compliance Library

## Digital Communication

### Regulatory Obligations

Exchange Act Rules 17a-3 and 17a-4, as well as FINRA Rule 3110(b)(4) (Review of Correspondence and Internal Communications) and FINRA Rule Series 4510 (Books and Records Requirements) require a firm to, among other things, create and preserve, in an easily accessible place, originals of all communications received and sent relating to its "business as such." If a firm permits its associated persons to use a particular application—for example, an app-based messaging service or a collaboration platform—the firm must preserve records of business-related communications and supervise the activities and communications of those persons on the application. Firms remain responsible for conducting due diligence to comply with the securities laws and FINRA rules and follow up on red flags of potentially violative activity and may, in some cases, use services provided by the relevant digital channel or third-party vendors.

### Noteworthy Examination Findings

FINRA has noted that some firms encountered challenges complying with supervision and recordkeeping requirements for various digital communications tools, technologies and services (collectively, "digital channels").

- **Use of Prohibited Digital Channels –** In some instances, firms prohibited the use of texting, messaging, social media or collaboration applications (*e.g.*, WhatsApp, WeChat, Facebook, Slack or HipChat) for business-related communication with customers, but did not maintain a process to reasonably identify and respond to red flags that registered representatives were using impermissible personal digital channel communications in connection with firm business. Red flags could be detected through, for example, customer complaints, representatives' email, outside business activity reviews or advertising reviews.
- **Prohibited Electronic Sales Seminars –** Some registered representatives conducted "electronic sales seminars" in a chatroom or on digital channels that were not permitted by their firms and were outside of supervision or recordkeeping programs.

### Effective Practices

Firms implemented a number of effective practices to manage registered representatives' use of digital channels.

- **Establishing Comprehensive Governance –** Some firms maintained governance processes to manage firm decisions and develop compliance processes for each new digital channel, as well as new features of existing channels. Such firms worked closely with their marketing, compliance and information technology departments, as well as their third-party vendors, to monitor the rapidly evolving array of communication methods available to their associated persons and customers.
- **Defining and Controlling Permissible Digital Channels –** Firms with holistic supervision and record retention programs and policies clearly defined permissible (as well as prohibited) digital channels; blocked prohibited digital channels (or prohibited features of permitted channels); restricted the use of messaging and collaboration apps that limit the firm's ability to comply with its recordkeeping requirements (such as apps with end-to-end encryption or self-destructing messages); established how permitted communications will be stored in a compliant manner; and implemented supervisory review procedures for communication and recordkeeping that are appropriate for the firm's business model and tailored to each digital channel.

- **Managing Video Content –** Some firms implemented WSPs to manage the lifecycle of video content, which could include, for example, live-streamed public appearances, scripted commercials or video blogs.
- **Training –** Some firms implemented mandatory training programs prior to providing registered representatives access to firm-approved digital channels. The training clarified the firms' expectations for business and personal digital communications, and assisted personnel with using all permitted features of each channel in a compliant manner.
- **Disciplining Misuse of Digital Communications –** Some firms temporarily suspended or permanently blocked from certain digital channels those registered representatives who did not comply with the firm's digital channel policies and required additional digital communications training.

### Additional Resources

- *Regulatory Notice 19-31* (Disclosure Innovations in Advertising and Other Communications with the Public)
- *Regulatory Notice 17-18* (Guidance on Social Networking Websites and Business Communications)
- Broker-Dealer Books and Records: New and Amended Recordkeeping Requirements Checklist
- Social Media Topic Page
- Books and Records Topic Page

## Anti-Money Laundering (AML)

### Regulatory Obligations

The Bank Secrecy Act (BSA) requires firms to monitor for, detect and report suspicious activity to the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN). Further, FINRA Rule 3310 (Anti-Money Laundering Compliance Program) requires that members develop and implement a written AML program reasonably designed to comply with the requirements of the BSA and regulations promulgated thereunder. FINRA also notes that FinCEN's CDD rule requires that firms identify beneficial owners of legal entity customers, understand the nature and purpose of customer accounts, conduct ongoing monitoring of customer accounts to identify and report suspicious transactions, and—on a risk basis—update customer information.[6]

### Noteworthy Examination Findings

FINRA identified the following issues relating to firms' AML programs, including challenges with transaction monitoring systems.

- **Inadequate AML Transaction Monitoring –** FINRA noted deficiencies in the design and implementation of systems and processes to detect and report suspicious activity:
  - Some firms did not tailor their transaction monitoring to address the risk(s) relating to the firms' business (for example, some firms did not adjust their AML programs for new sources of revenue or higher-risk customers with increased levels of activity, and other firms relied on FINRA's AML resources without tailoring them to the firms' business);[7]
  - Deficient transaction monitoring for suspicious trading and possible related money-laundering activity, which may have been due to an ongoing misconception that securities trading does not need to be monitored for suspicious activity reporting purposes, or inadequate delegation of duties to a group outside of the AML department (*e.g.*, the securities trading desk). As a result, some firms failed to detect red flags such as market dominance, prearranged trading or instances where groups of seemingly unrelated accounts were working in concert to manipulate stock prices; and
  - Transaction monitoring processes that were not reasonably designed to identify and investigate red flags associated with third-party wire transfers, where such red flags might include transfer requests that are out of the ordinary for the customer or appear designed to deter verification of the transfer instructions.
- **Overreliance on Clearing Firms –** FINRA found that some introducing firms continued to rely primarily or entirely on their clearing firm for transaction monitoring and suspicious activity reporting. While clearing firm inquiries about certain customers or activities can be triggers for further review by introducing firms, introducing firms are required to monitor for suspicious activity attempted or conducted through the firm.[8]

### Additional Resources

- *Regulatory Notice 19-18* (Guidance Regarding Suspicious Activity Monitoring and Reporting Obligations)
- 2017 Report – Anti-Money Laundering (AML) Compliance Program
- 2018 Report – Anti-Money Laundering
- Anti-Money Laundering (AML) Template for Small Firms
- Frequently Asked Questions (FAQ) Regarding Anti-Money Laundering (AML)
- Anti-Money Laundering (AML) Topic Page

# Uniform Transfers to Minors Act (UTMA) and Uniform Grants to Minors Act (UGMA) Accounts

## Regulatory Obligations

FINRA Rule 2090 (Know Your Customer) requires member firms and their associated persons to use reasonable diligence to determine the "essential facts" about every customer and "the authority of each person acting on behalf of such customer." *Regulatory Notice 11-02* (SEC Approves Consolidated FINRA Rules Governing Know-Your-Customer and Suitability Obligations) advised that firms verify the essential facts about a customer "at intervals reasonably calculated to prevent and detect any mishandling of a customer's account that might result from the customer's change in circumstances."

## Noteworthy Examination Findings

Generally, when UTMA or UGMA accounts (UTMA/UGMA Accounts) are established, the beneficiary (a minor) becomes the owner of the property at the time of the gift; however, the custodian manages and invests the property on the beneficiary's behalf until the beneficiary reaches the age of majority, at which point the custodian is required to transfer the custodial property to the beneficiary.

FINRA noted that some firms did not establish, maintain or enforce a supervisory system reasonably designed to achieve compliance with their continuing obligation to know the essential facts of their UTMA/UGMA Account customers. Specifically, the circumstances concerning the authority of a person acting on behalf of a customer will change in UTMA/UGMA Accounts when the account beneficiary reaches the age of majority.

FINRA found that many firms were aware of the need to transfer responsibility for the account at a future date because they had policies and procedures addressing this topic, such as noting the date of majority when setting up the account. However, even though they were aware of the need to transfer the account at a future date, some firms did not take any steps to track or monitor when beneficiaries would reach the age of majority, while other firms had procedures for their registered representatives to follow, but did not require any supervisory oversight. Further, in some instances, firms permitted custodians to effect transactions in, and withdraw, journal and transfer money from UTMA/UGMA Accounts months, or even years, after the beneficiaries reached the age of majority, and ignored red flags of such activity (*e.g.*, customer complaints relating to such transactions).

## Effective Practices

Some firms implemented a number of effective practices for verifying the authority of custodians of UTMA/UGMA Accounts.

- **Age of Majority –** Some firms maintained supervisory systems and used automated tools to track when each UTMA/UGMA Account beneficiary reached the age of majority.
- **Notification to Custodians –** Some firms issued letters or provided notifications to custodians to advise them that beneficiaries were approaching the age of majority and informed them about upcoming transfers of custodial property in their UTMA/UGMA Accounts, as well as any restrictions to the custodians' trading authority after the beneficiaries reached the age of majority.
- **Notification to Registered Representatives –** Some firms maintained systems to provide registered representatives with automated alerts when beneficiaries reached the age of majority and required them to communicate with the custodian about the transfer of custodial property.

## Observations on Cybersecurity

While many firms have made significant improvements in their cybersecurity programs, cybersecurity attacks continue to increase in both number and level of sophistication. FINRA notes that such attacks often take advantage of and highlight weaknesses in a firm's cybersecurity program. The observations and effective practices we share below can help firms strengthen their cybersecurity programs and may support compliance with the SEC's Regulation S-P, which requires firms to have policies and procedures addressing the protection of customer records and information.[9]

We encourage firms to strengthen their cybersecurity programs by taking advantage of FINRA publications and other resources identified below. FINRA recognizes that there is no one-size-fits-all approach to cybersecurity, and reminds firms to evaluate each of the controls described in this report and other FINRA resources in the context of their business model and risk profile.

Highlighted below are effective practices some firms have implemented to strengthen their cybersecurity risk-management programs.

- **Branch Controls –** Firms maintained branch-level written cybersecurity policies to protect confidential data. In addition, they implemented procedures to verify that branch office controls were implemented and functioning adequately, either via automated monitoring tools or during in-person branch inspections.
- **Documented Policies on Vendor and Third-Party Management –** Firms using third-party vendors that provide critical firm services or handle sensitive client information adopted, implemented, and documented formal policies and procedures to manage the lifecycle of the firm's engagement with the vendor (*i.e.*, from onboarding, to ongoing monitoring, through off-boarding, including defining how vendors will dispose of sensitive client information).
- **Incident Response Planning –** Firms established and regularly tested written formal incident response plans that outlined procedures they would follow when responding to cybersecurity and information security incidents. Firms also developed procedures relating to incident response plans, which included a mechanism to appropriately identify, classify, prioritize, track and close cybersecurity-related incidents.
- **Data Protection Controls –** Firms encrypted all confidential data, including sensitive customer information and firm information, whether stored internally or at vendors' locations.
- **System Patching –** Firms adopted procedures to implement timely application of system security patches to critical firm resources (*e.g.*, servers, network routers, desktops, laptops and software systems) to protect sensitive client or firm information.
- **Access Controls –** Firms implemented or maintained policies and procedures to grant system and data access only when required (often referred to as "Policy of Least Privilege") and removed such access when it was no longer needed (such as when individuals departed or changed roles at the firm). In addition, firms tracked (and monitored the activities of) individuals granted administrator access to data or systems. Further, firms implemented multi-factor or two-factor authentication controls for registered representatives, employees, vendors and contractors accessing firm systems and data from outside the organization.
- **Management of Asset Inventory –** Some firms created and kept current an inventory of critical information technology assets—including hardware, software and data—in home and branch offices. These inventories also included legacy assets that vendors no longer supported, as well as corresponding cybersecurity controls to protect those assets.

- **Data Loss Prevention Controls –** Certain firms implemented data loss prevention controls to protect a broad range of sensitive customer information in addition to Social Security numbers, such as other account profile information (*e.g.*, account numbers, dates of birth, bank information and driver's license numbers).
- **Training and Awareness –** Firms provided robust cybersecurity training for registered representatives, personnel, third-party providers and consultants. This training addressed key topics relevant to individuals' roles and responsibilities (*e.g.*, training on the various types of phishing emails that might be directed towards registered representatives' associates or home office staff in the human resources or finance departments, or training on secure software development practices for developers). Some firms determined the appropriate frequency of such training based on the cybersecurity risk exposure associated with the firm, as well as individuals' roles and responsibilities.
- **Change Management Processes –** Some firms implemented change management procedures to document, review, prioritize, test, approve, and manage hardware and software changes in order to protect sensitive information and firm services.

## Additional Resources

- Report on Cybersecurity Practices – 2015
- Report on Selected Cybersecurity Practices – 2018
- 2017 Report – Cybersecurity
- Small Firm Cybersecurity Checklist
- Core Cybersecurity Controls for Small Firms
- Customer Information Protection Topic Page
- Cybersecurity Topic Page
- Cybersecurity category of the Peer-2-Peer Compliance Library
- Non-FINRA Cybersecurity Resources

## Business Continuity Plans (BCPs)

### Regulatory Obligations

FINRA Rule 4370 (Business Continuity Plans and Emergency Contact Information) requires firms to create and maintain a written BCP with procedures that are reasonably designed to enable firms to meet their obligations to customers, counterparties and other broker-dealers during an emergency or significant business disruption.[10] The rule also requires firms to review and update their BCPs, if necessary, in light of changes to firms' operations, structure, business or location. Further, although most introducing firms rely, to some extent, on their clearing firms to allow customers to access their accounts and enter transactions, they are responsible for compliance with the BCP rule.

### Noteworthy Examination Findings

FINRA found some firms encountering challenges where their BCPs did not reflect certain market conditions, business models or other circumstances.

- **Incomplete Mission-Critical Systems –** Some firms' BCPs did not identify all of their mission-critical systems. Omitted systems included those used for order management for trading desks, or vendor systems that processed and managed financing transactions, such as securities lending and repurchase agreements.
- **Insufficient Capacity –** Some larger firms did not have sufficient capacity to handle substantially increased call volumes and online activity during a business disruption, which affected customers' ability to access their accounts.
- **No Updates for Operational Changes –** Some firms did not update their BCPs after significant operational changes, such as outsourcing critical operational functions, relocating data centers or replacing other key systems, including trading desk order management systems or other systems that are critical to firms' business lines.
- **Outdated Contact Information –** Some firms' BCPs contained outdated emergency contact information and did not identify how customers could access their funds and securities during a business disruption.
- **Local Document Storage –** Some firms allowed employees to maintain critical working documents on their computers' local drives rather than requiring that they be stored on the firms' network. Firms should review their controls to test whether these files would be secure and readily accessible.
- **No Registered Principal Registrations –** Some senior management personnel, who were responsible for performing the annual BCP review, did not maintain the required registered principal registration.[11]

### Effective Practices

Firms implement a number of effective practices to fulfill their obligations under the rule, especially those relating to testing of their BCP plans.

- **Engaging in Annual Testing –** Firms tested their BCPs as part of their annual review to confirm that the BCP was updated, and to evaluate its effectiveness, especially with respect to the functioning of mission-critical systems and processes, availability of key personnel and access to physical contingency site location(s). As part of these tests, some firms assessed their remote access capabilities to such systems, as well as evaluated and documented their ability to failover from one server to another. Firms also included key vendors in their BCP tests and documented results from those tests.

- **Incorporating Test Results into Firm Training –** Firms found these tests can be a valuable tool, not only to identify weaknesses in their BCPs, but also to train staff on how to implement the program, should that become necessary.

### Additional Resources

- *Regulatory Notice 19-06* (FINRA Requests Comment on the Effectiveness and Efficiency of Its Rule on Business Continuity Plans and Emergency Contact Information)
- *Regulatory Notice 19-15* (FINRA Publishes Consolidated Criteria to Designate Firms for Mandatory Participation in FINRA's Business Continuity/Disaster Recovery Testing)
- Business Continuity Plan FAQs
- Small Firm Business Continuity Plan Template
- Business Continuity Planning Topic Page

## Fixed Income Mark-up Disclosure

### Regulatory Obligations

FINRA's and the Municipal Securities Rulemaking Board's (MSRB) amendments to FINRA Rule 2232 (Customer Confirmations) and MSRB Rule G-15 require firms to provide additional transaction-related pricing information to retail customers for certain trades in corporate, agency and municipal debt securities (other than municipal fund securities).[12]

### Noteworthy Examination Findings

FINRA identified many of the issues previously discussed in the Fixed Income Mark-up Disclosure section of the 2018 Report, as well as the following additional issues.

- **Excluding Charges from Mark-Up/Mark-Down Disclosure –** Some firms disclosed additional charges separately from disclosed mark-ups or mark-downs, even when such charges reflected firm compensation. Firm compensation should not be mischaracterized, for example, as miscellaneous or fixed transaction fees; it should instead be included in the reported price of the transaction and accounted for when calculating mark-ups and mark-downs, consistent with applicable rules and guidance.[13]
- **Unclear or Inaccurate Labels for Sales Credits or Concessions –** Some firms disclosed registered representatives' sales credits or concessions as separate line items on confirmations, in addition to the mark-up or mark-down, without clear and accurate labeling, creating confusion about the actual disclosed mark-up and therefore diminishing its utility.[14] Similarly, some firms inaccurately labeled only the sales credits or concessions portion as the total mark-up or mark-down.
- **Incorrect Prevailing Market Price (PMP) Determinations –** Some firms did not determine the PMP as set forth in FINRA Rule 2121.02(b) (Additional Mark-Up Policy for Transactions in Debt Securities, Except Municipal Securities) for their fixed income transactions. Some firms' PMP determinations did not presumptively rely on the dealer's contemporaneous cost or proceeds, as required by Rule 2121. Other firms decided that their cost or proceeds were no longer "contemporaneous" without sufficient evidence as required by Rule 2121.02(b)(4) and used other pricing information to determine the PMP.
- **Inaccurate Time of Execution –** Some firms disclosed times of execution on customer confirmations that did not match the times of execution disseminated by the Electronic Municipal Market Access system (EMMA) or Trade Reporting and Compliance Engine (TRACE).[15] The time of execution on confirmations must match the trade times disseminated by EMMA and TRACE to allow customers to identify their specific transactions, consistent with the intent of the disclosure requirement.

### Additional Resources

- *Regulatory Notice 17-24* (FINRA Issues Guidance on the Enhanced Confirmation Disclosure Requirements in Rule 2232 for Corporate and Agency Securities)
- Report Center – FINRA's MSRB Markup/Markdown Analysis Report
- Report Center – FINRA's TRACE Markup/Markdown Analysis Report
- Fixed Income Confirmation Disclosure: Frequently Asked Questions (FAQ)
- Municipal Securities Topic Page
- Fixed Income Topic Page

# Best Execution

## Regulatory Obligations

FINRA Rule 5310 (Best Execution and Interpositioning) requires firms to conduct a "regular and rigorous" review of the execution quality of customer orders if the firm does not conduct an order-by-order review.[16] Where "regular and rigorous" reviews are used instead of order-by-order reviews, the reviews must be performed at a minimum on a quarterly basis and on a security-by-security, type-of-order basis (*e.g.*, limit order, market order and market on open order). If a firm identifies any material differences in execution quality among the markets that trade the securities under review, it must modify its routing arrangements or justify why it is not doing so.

## Noteworthy Examination Findings

FINRA continued to identify issues with some firms' execution quality reviews, as well as conflicts of interest and related disclosures.

- **No Execution Quality Assessment of Competing Markets –** Some firms did not compare the quality of the execution of their existing order routing and execution arrangements against the quality of executions that the firm could have obtained from competing venues.
- **No Review of Certain Order Types –** In some instances, firms did not conduct adequate reviews on a type-of-order basis, including, for example, on market, marketable limit or non-marketable limit orders.
- **No Evaluation of Required Factors –** Some firms did not consider factors set forth in FINRA Rule 5310 (Best Execution and Interpositioning) when conducting their execution quality reviews, including, among other things, the speed of execution, price improvement opportunities and the likelihood of execution of limit orders.
- **Conflicts of Interest –** Some firms did not adequately consider and address potential conflicts of interest relating to their routing of orders to affiliated alternative trading systems (ATSs) or market centers that provide payment for order flow or other routing inducements. In addition, some firms continue to route significant portions of their order flow to such venues without conducting an adequate "regular and rigorous" review to support such routing decisions.
- **Inadequate SEC Rule 606 Disclosures –** Some firms did not provide adequate information in the material disclosures section of their order routing reports required by Rule 606 of Regulation NMS. For example, certain firms did not disclose, when required, the specific, material aspects of the non-directed order flow routed to their own trading desk, including that the firm stands to share in 100 percent of the profits generated by the firm's trading as principal with its customers' orders.[17] Other firms did not disclose material aspects of their relationships with each of the significant venues identified on their reports, including descriptions and terms of all arrangements for payment for order flow (including the amounts of payment for order flow on a per share or per order basis)[18] and profit-sharing relationships that may have influenced the firms' order routing decisions.

## Additional Resources

- 2017 Report – Best Execution
- 2018 Report – Best Execution
- *Regulatory Notice 15-46* (Guidance on Best Execution Obligations in Equity, Options and Fixed Income Markets)
- Report Center, Equity Report Cards section – FINRA's Best Execution Outside-of-the-Inside Report Card

## Direct Market Access Controls

### Regulatory Obligations

Compliance with Exchange Act Rule 15c3-5 (Market Access Rule) requires firms that provide access to trading in securities on an exchange or ATS to incorporate appropriate controls to mitigate key risks. The Market Access Rule is particularly important with the continued increase in automated and high-speed trading.

### Noteworthy Examination Findings

FINRA continued to find many of the same issues identified in the Market Access Controls sections of the 2017 and 2018 Reports, as well as additional challenges with certain other market access controls, especially those related to fixed income transactions.

- **Insufficient Controls and WSPs –** Some firms' risk management controls and WSPs did not include pre-trade order limits, pre-set capital thresholds and duplicative and erroneous order controls for accessing ATSs, especially for fixed income transactions.
- **Inadequate Financial Risk Management Controls –** In some instances, firms with market access, or those that provide it, did not establish appropriate capital thresholds for trading desks, aggregate daily limits, or credit limits on institutional customers and counterparties. In some instances, firms with market access, or those that provide it, did not have reasonably designed risk-management controls or WSPs to manage the financial, regulatory or other risks associated with this business activity. Firms should regularly assess the appropriateness of their capital thresholds and pre-set credit limits for each customer.
- **Inadequate Basis for CEO Certification –** Some firms did not maintain reasonably designed risk-management controls that could support the CEO's certification pursuant to the requirements of Exchange Act Rule 15c3-5(e)(2).
- **Inaccurate Intra-day (Ad Hoc) Adjustments –** FINRA identified weaknesses in some firms' processes for requesting, approving, reviewing and documenting ad hoc credit threshold increases. For example, institutional clients requested ad hoc (daily) adjustments to financial limits in anticipation of increased order activity related to events such as an index rebalancing or a public offering, but once the event concluded (typically the next trading day), firms did not return the limits to their original values. Some firms maintained a manual process for reverting limits to their original values or did not revert the elevated credit limits in a timely fashion, which exposed clients and firms to elevated levels of financial risk.
- **Ineffective Erroneous Trading Controls –** Some firms failed to implement adequate controls relating to duplicative and erroneous orders. For example, some firms set controls to prevent the routing of a market order based on impact (Average Daily Volume Control) at unreasonable levels, preventing such firms from blocking erroneous trades. These controls can be effective tools (particularly in thinly traded securities) when set at reasonably high levels, and firms should calibrate them to reflect, among other things, the characteristics of the relevant securities, the business of the firm, and market conditions.
- **Insufficient Post-Trade Controls and Surveillance –** Some firms that provide direct market access via multiple systems, including sponsored access arrangements, did not employ reasonable controls to confirm that those systems' records were aggregated and integrated in a timely manner. As a result, those firms were not able to successfully conduct holistic post-trade and supervisory reviews for, among other things, potential manipulative trading patterns.

### Additional Resources

- *Regulatory Notice* *15-09* (Guidance on Effective Supervision and Control Practices for Firms Engaging in Algorithmic Trading Strategies)
- *Regulatory Notice* *16-21* (SEC Approves Rule to Require Registration of Associated Persons Involved in the Design, Development or Significant Modification of Algorithmic Trading Strategies)
- Algorithmic Trading Topic Page
- Market Access Topic Page

## Short Sales

### Regulatory Obligations

Regulation SHO Rules 200 to 204 require firms to address risks relating to market manipulation, market liquidity and investor confidence by regulating excessive and “naked” short sales so that purchasers of securities from short sellers receive their securities positions in a timely manner. Regulation SHO requires firms to appropriately mark their securities orders; confirm that they have deliverable securities to complete short sale transactions; and have a process to close-out fails to deliver within the required timeframes.

### Noteworthy Examination Findings

In addition to the findings FINRA shared in the Regulation SHO section of the 2017 Report, we found some firms were not able to satisfy the Continuous Net Settlement (CNS) System fail-to-deliver close-out requirements pursuant to Rule 204 because they did not implement a sufficient process to age fails, resulting in fails not being closed out timely. In other instances, firms did not accurately allocate CNS fails to correspondents. For example, some firms faced challenges relating to both inaccurate calculation of pre-fail credits prior to allocating fails to the correspondent, and used inconsistent methods when allocating fails to the correspondents where the share quantities exceeded the CNS fails.

In addition, firms may consider as an effective practice to periodically review their policies relating to rates charged for borrowing, sourcing or locating securities in connection with short sales, including monitoring the aging of short positions and determining whether the rates assigned at the onset of those positions are still appropriate.

## Observations on Liquidity and Credit Risk Management

Effective liquidity and credit risk management controls are critical elements in a broker-dealer's risk management framework, and should be documented in a firm's books and records.[19] FINRA routinely reviews firms' practices in these areas, and in *Regulatory Notice* *15-33* (Guidance on Liquidity Risk Management Practices) shared observations on liquidity management practices.

FINRA shares the following practices that some firms used to strengthen their liquidity management programs.

- **Liquidity Contingency Plans –** Small clearing and introducing firms developed contingency plans for operating in a stressed environment and outlined specific steps to address certain stress conditions. Further, firms' contingency plans identified the firm staff responsible for enacting the plan, the process for accessing liquidity during a stress event or standards to determine how liquidity funding would be used.
- **Liquidity Risk Management Updates –** Firms updated their liquidity risk management practices to take into account their current business activities.
- **Stress Tests –** Firms conducted stress tests in a manner and frequency that was appropriate for their business model. In addition, such stress tests evaluated the potential impact of off-balance sheet items on liquidity. Some firms that relied on a shared funding source with affiliated entities for their liquidity stress test and their shared Master Credit Agreement confirmed that source would be ring-fenced for them during a stress event.
- **Credit Risk Management –** Firms maintained a robust internal control framework to capture, measure, aggregate, manage and report credit risk.[20] In particular, firms evaluated their risk management and control processes to review whether they were accurately capturing their exposure to credit risk; maintained approval and documentation processes for increases or other changes to assigned credit limits; and monitored exposure to their affiliated counterparties.

### Additional Resources

- 2018 Report – Liquidity
- *Regulatory Notice* *10-57* (Funding and Liquidity Risk Management Practices)
- Funding and Liquidity Topic Page

## Segregation of Client Assets

### Regulatory Obligations

Exchange Act Rule 15c3-3 (Customer Protection Rule) requires firms that maintain custody of customer securities and safeguard customer cash to segregate these assets from the firm's proprietary business.

### Noteworthy Examination Findings

FINRA has continued to identify many of the same concerns noted in the Segregation of Client Assets section of the 2018 Report, including challenges with check-forwarding and possession or control.

- **Omitted or Inaccurate Blotter Information –** Some firms' blotters lacked sufficient information to demonstrate that checks were forwarded in a timely manner or contained inaccurate information with respect to the status of checks.
- **Inadequate Possession or Control Processes –** FINRA noted the following deficiencies:
  - Failure to obtain documentation (no lien letters) from custodians and issuers to show that all securities in a good control location were free of liens that could be exercised by a third party on the firm;
  - Inability to identify deficits in fully paid and excess margin securities when certain firms did not correctly age the deficits due to errors in their formulas;
  - Failure to confirm that fully paid securities were correctly segregated at custodian banks (FINRA notes that firms should consider verifying whether they have sufficient securities positions that exceed possession or control requirements prior to transferring such excess securities from a custodial account); and
  - Failure to combine balances and positions in related customer securities accounts and accounts with the same Taxpayer Identification Numbers in order to determine the extent to which the market value of securities carried for the customer's account exceeded 140 percent of the customer's debit balance.
- **Inaccurate Reserve Formula Calculations –** Some firms did not exclude concentrated margin debit balances[21] because they did not have a process to identify accounts under common control or related customer accounts.
- **Coding Errors –** FINRA noted joint customer and firm officer accounts miscoded as "non-customer" rather than "customer." Some firms also coded foreign bank accounts as "PAB" without obtaining a written agreement acknowledging that the accounts are proprietary transactions of the foreign bank.[22]

### Additional Resources

- Interpretations of Financial and Operational Rules
- Customer Protection – Reserves and Custody of Securities (SEA Rule 15c3-3)

# Net Capital Calculations

## Regulatory Obligations

Exchange Act Rule 15c3-1 (Net Capital Rule) requires firms to maintain net capital at specific levels to protect customers and creditors from monetary losses that can occur when firms fail.

## Noteworthy Examination Findings

FINRA has continued to identify some of the same concerns noted in the Net Capital and Credit Risk Assessments section of the 2017 Report and Accuracy of Net Capital Calculations section of the 2018 Report, as well as the following additional issues.

- **Incorrect Inventory Haircuts –** Some firms did not apply correct haircut charges when computing net capital because they did not adequately assess and monitor the creditworthiness of fixed income securities, such as corporate debt and collateralized mortgage obligations (CMOs), to determine whether these products have a "minimal amount of creditworthiness" pursuant to Exchange Act Rule 15c3-1(c)(2)(vi)(I).[23]
- **Incorrect Capital Charges for Underwriting Commitments –** Some firms did not maintain an adequate process to assess moment-to-moment and open contractual commitment capital charges on underwriting commitments and did not understand their role as it pertained to the underwriting (*i.e.*, best efforts or firm commitment).[24]
- **Inaccurate Classification of Receivables, Liabilities and Revenue –** In some instances, firms inaccurately classified receivables, liabilities and revenues, which resulted in inaccurate reporting of a firm's financial position and, in some instances, a capital deficiency. In addition, upon settlement of a customer claim, some firms understated their liability by recognizing the monies due to the customer based on a payment schedule instead of recognizing the full amount owed at the time of settlement.
- **Recognition of Insurance Claims –** Some firms did not recognize on their books and records receivables due from insurance carriers and the corresponding liabilities owed to customers. Other firms did not obtain an opinion of counsel with respect to claims within seven business days, as required under Exchange Act Rule 15c3-1(c)(2)(iv)(D), thereby resulting in the receivables not being allowable for purposes of net capital, and the firm being required to take the full charge for the customer claim.
- **Inadequate Documentation of Methodology for Expense-Sharing Agreements –** Some firms did not maintain sufficient documentation to substantiate their methodology for allocating specific broker-dealer costs to the firm or an affiliate. Some firms were not accurately accruing expenses—such as technology fees, marketing charges, retirement account administrative fees and employees' compensation—on their books and records. Further, some firms incorrectly netted intercompany accounts with different affiliated entities,[25] resulting in books and records that did not accurately reflect the firms' operating performance and financial condition.

## Additional Resources

- Interpretations of Financial and Operational Rules
- *Notice to Members 03-63* (SEC Issues Guidance on the Recording of Expenses and Liabilities by Broker/Dealers)

## ENDNOTES

1. *See Regulatory Notice 10-19* (FINRA Reminds Firms of Responsibilities When Providing Customers with Consolidated Financial Account Reports).

2. On June 5, 2019, the SEC voted to adopt a package of rulemakings and guidance, including Regulation Best Interest (Reg BI). This section is intended to provide firms with findings solely related to compliance with existing FINRA suitability and related supervisory obligations and does not address Reg BI. For additional information, please see FINRA's Topic Page on SEC Regulation Best Interest (Reg BI).

3. In addition to the items discussed in this document, FINRA reminds firms to consider the findings FINRA shared previously regarding overconcentration in illiquid securities, reasonable due diligence for private placements and certain variable annuity exchanges.

4. *See* FINRA Rule 2330(d) (Members' Responsibilities Regarding Deferred Variable Annuities).

5. FINRA continued to note many of the challenges we discussed in the Abuse of Authority section of the 2018 Report, including registered representatives engaging in discretionary trading without written authorization.

6. *See Regulatory Notices 17-40* (FINRA Provides Guidance to Firms Regarding Ant-Money Laundering Program Requirements Under FINRA Rule 3310 Following Adopting of FinCEN's Final Rule to Enhance Customer Due Diligence Requirements For Financial Institutions) and *18-19* (FINRA Amends Rule 3310 to Conform to FinCEN's Final Rule on Customer Due Diligence Requirements for Financial Institutions) for additional information.

7. *See Regulatory Notice 19-18* (FINRA Provides Guidance to Firms Regarding Suspicious Activity Monitoring and Reporting Obligations) for a list of potential red flags that firms should consider when designing an effective AML compliance program that is tailored to their business.

8. *See* Frequently Asked Questions (FAQ) Regarding Anti-Money Laundering (AML), Question No. 22.

9. This obligation includes protection against any anticipated threats or hazards to the security or integrity of customer records and information, as well as unauthorized access to or use of such records or information. Also, the rule requires firms to provide initial and annual privacy notices to customers describing information sharing policies and informing customers of their rights.

10. Pursuant to *Regulatory Notice 19-06* (FINRA Requests Comment on the Effectiveness and Efficiency of Its Rule on Business Continuity Plans and Emergency Contact Information), FINRA is conducting a retrospective review of Rule 4370. This section is intended to provide firms with findings solely relating to compliance with existing Rule 4370 and does not address the outcome of that review or any potential revisions to the rule.

11. *See* FINRA Rule 4370(d).

12. Specifically, the amendments require firms to disclose the mark-up or mark-down for principal trades with retail customers that a firm offsets on the same day with other principal trades in the same security. Disclosed mark-ups and mark-downs must be expressed as both a total dollar amount for the transaction and a percentage of PMP. In addition, for all retail customer trades in corporate, agency and municipal debt securities (other than municipal fund securities), firms must disclose on the confirmation the time of execution and a security-specific link to the FINRA or MSRB website where additional information about the transaction is available, along with a brief description of the information available on the website.

13. *See, e.g.*, Frequently Asked Questions (FAQ) About the Trade Reporting and Compliance Engine (TRACE) FAQ *3.1.33* (stating that prices reported to TRACE should be inclusive of mark-ups and mark-downs).

14. *See* FINRA Fixed Income Confirmation Disclosure: Frequently Asked Questions (FAQ), FAQ 2.3 and MSRB Confirmation Disclosure and Prevailing Market Price Guidance: Frequently Asked Questions, FAQ 2.3.

15. *See* FINRA Fixed Income Confirmation Disclosure: Frequently Asked Questions (FAQ), FAQ 4.2; MSRB Confirmation Disclosure and Prevailing Market Price: Frequently Asked Questions, FAQ 4.2.

16. *See also Regulatory Notice 15-46* (Guidance on Best Execution Obligations in Equity, Options and Fixed Income Markets).

17. *See* U.S. Securities and Exchange Commission, Division of Market Regulation: Staff Legal Bulletin No. 13A Frequently Asked Question about Rule 11Ac1-6, Question 14: Disclosing Internalized Order Flow.

18. *See* U.S. Securities and Exchange Commission, Division of Market Regulation: Staff Legal Bulletin No. 13A Frequently Asked Question about Rule 11Ac1-6, Question 13: Disclosing Payment for Order Flow.

19. *See* Exchange Act Rule 17a-3(a)(23).

20. *See* Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 70072 (July 30, 2013), 78 Fed. Reg. 51824 (Aug. 21, 2013), at 51848; *see also* FINRA's Resource Page for the SEC's July 2013 Financial Responsibility Rule Amendments.

21. *See* the SEC's Note E(5) to Exhibit A of SEA Rule 15c3-3 and the associated interpretation, Determination of the Includible Amount of a Customer's Concentrated Margin Debit Balance in the Reserve Formula, Exchange Act Rule 15c3-3, Exhibit A - Note E(5)/01, in the Interpretations of Financial and Operational Rules.

22. Regarding foreign banks, *see* Foreign Banks - Customer and Non-Customer Classification, Exchange Act Rule 15c3-3(a)(1)/032, in the Interpretations of Financial and Operational Rules.

23. These requirements were adopted as part of the SEC's 2013 credit ratings amendments. *See* Exchange Act Release No. 71194 (Dec. 27, 2013), 79 Fed. Reg. 1522 (Jan. 8, 2014).

24. *See* Exchange Act Rule 15c3-1(c)(2)(viii); *see also* Moment to Moment Net Capital, Exchange Act Rule 15c3-1(a)(1)/001, in the Interpretations of Financial and Operational Rules.

25. *See* Netting of Intercompany Receivables and Payables with Affiliates, Exchange Act Rule 15c3-1(c)(2)(iv)(C)/073 in the Interpretations of Financial and Operational Rules.