

# FINRA 2019 Annual Budget Summary

## Chairman and CEO Letter



**William H. Heyman**  
Chairman



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

FINRA performs a vital role in the U.S. financial regulatory structure: overseeing securities brokerage firms and individual brokers doing business with the public. Our mission is to protect investors and promote market integrity in a manner that facilitates vibrant capital markets. Under the supervision of the U.S. Securities and Exchange Commission (SEC), FINRA advances this mission through a wide range of regulatory functions every day, including examining firms and individuals for compliance with regulatory requirements; providing tools and resources to aid in achieving compliance; conducting ongoing surveillance of trading in the U.S. securities markets for potential misconduct; bringing enforcement actions to address violations of industry rules and regulations; and providing industry-wide utilities such as disclosure and trade reporting facilities.

As a not-for-profit, self-regulatory organization whose operations are funded by industry fees—without the support of any taxpayer dollars—FINRA must prudently manage its finances to ensure it can appropriately fund its mission. FINRA’s regulatory responsibilities remain extensive and complex, and continue to expand as the SEC relies more heavily on FINRA to supervise broker-dealers. Total assets under management by member firms have increased, the number of registered representatives has remained largely constant, and market innovations in financial technology and other areas continue to present new regulatory challenges.

In the interest of promoting greater transparency regarding the funding of our operations, last year FINRA published for the first time the key concepts and considerations that guide FINRA’s longer-term financial planning and the development of our annual budget. These Financial Guiding Principles were published alongside an overview of FINRA’s 2018 annual budget, and were reaffirmed by the FINRA Board of Governors in December 2018. They are set forth below in full.

Building again on these Principles, we are publishing our 2019 Annual Budget Summary, a forward-looking document designed to complement the audited Annual Financial Report we have long released each year to describe our finances and operations over the prior year. This Budget Summary outlines how we plan to deploy our resources to meet FINRA’s varied and complex regulatory responsibilities this year. As our member firms continue to adapt and innovate, so too must FINRA’s approach to new regulatory challenges.

As described in the Budget Summary, 2019 operating revenue of \$846.9 million is projected to be flat compared to 2018. Revenue from regulatory fees—including fees that are primarily assessed according to firms’ gross revenue and trading volume, and firms’ total number of registered representatives—are projected to increase. However, user fees, which comprise approximately one-third of operating revenue, are expected to decrease, primarily driven by lower registration fees, changes in transparency services’ trade volume in the over-the counter market and declining testing exam volume.

Operating expenses, meanwhile, are projected to increase 3.7 percent in 2019, due primarily to increases in compensation- and technology-related expenses. Since 2015, increases in overall operating expenses have stayed largely in line with inflation, at an annual rate of about 1.6 percent. Last year we carefully managed our expenses to align with our budget, and we will continue to focus on doing so without compromising our ability to fulfill our mission.

The compensation-related increases in 2019 follow several years of reductions to incentive compensation and salary freezes for more senior employees. As described in our Financial Guiding Principles, the Board's Management Compensation Committee reviews and approves the salary structure and the annual incentive compensation pool for the organization, with the advice of an independent compensation consultant, and each year provides a report that is included in FINRA's Annual Financial Report.

We anticipate capital initiative spending of \$97.3 million in 2019. Among the projects underway are a multi-year transformation of our external-facing digital platform in an effort to facilitate compliance by member firms, a redesign of our workforce training and development programs, and an initiative to upgrade the platform that supports FINRA's trade reporting facilities to better handle current market requirements at reduced costs. We are continuing to bring more FINRA applications to the cloud—an up-front investment that avoids the long-term costs of maintaining our own data centers and enables FINRA to promptly and automatically add data processing and storage capacity—and we are implementing a transformation of our registration systems that will make them more efficient for firms and brokers while bolstering compliance.

Due to the expiration of existing leases for our New York City office space, we are modifying our footprint in that region and relocating some functions to lower-cost properties. We have budgeted \$15.5 million for relocation costs and related renovations to new and existing office space. Our 2019 budget also includes \$18.3 million for external mandates, including implementation costs related to the usage of Consolidated Audit Trail (CAT) data—which are separate and apart from any costs incurred by FINRA as plan processor—and implementation and ongoing support for trade reporting for U.S. Treasury securities.

The Budget Summary continues to reflect the intentionally conservative methodology we adopted last year, which assumes there are no fine monies available to support capital initiatives, and that there are no investment gains or losses on our financial reserves. Fine monies are excluded because they are not driven by revenue targets. Under our Financial Guiding Principles, they are accounted for separately and their use must be approved by the Board of Governors or its Finance Committee for enumerated purposes. We will publish a separate report describing the use of fine monies from 2018, as we did for 2017.

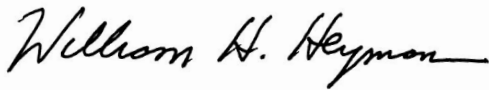
Taking into account these assumptions, the difference between our projected 2019 revenues and expenses could result in a draw on our reserves of \$185.8 million (referred to as the Potential Reserve Reliance). This presentation helps us understand at the beginning of the year, for budgeting purposes, how reliant we may have to be on our reserves during the course of the year. However, in practice, our actual net income—to be reflected in our 2019 Annual Financial Report—will ultimately include fines, investment returns and other accounting adjustments. For reference, our 2017 budget included a Potential Reserve Reliance of \$142.8 million, but we ultimately reported GAAP net income in our 2017 Annual Financial Report of \$41.6 million. Our 2018 budget included a Potential Reserve Reliance of \$138.1 million. We will report GAAP results for the year in our 2018 Annual Financial Report this summer.

FINRA's long-term financial plan, as reflected in our Financial Guiding Principles, assumes we will increase member fees only after evaluating other sources of funding, including drawing down on excess reserves, and that we will also rely on reserves from time to time as we increase capital and initiative spending to meet our regulatory responsibilities. Consistent with these Principles, we will not seek to increase member fees this year—the sixth consecutive year without a fee increase—and instead will close any shortfall with the use of our reserves.

Ongoing reliance on excess reserves in lieu of fee increases, as contemplated by the Financial Guiding Principles, will eventually result in several years of net losses. Those will be reported in our Annual Financial Report as they occur, until the level of reserves approaches our annual expenditures, at which point fee increases *will* become necessary. In the meantime, FINRA continues to plan for ensuring the long-term financial sustainability of the organization and its ability to meet the regulatory challenges ahead. As the Principles outline, that means managing our expenses responsibly, monitoring and planning for reasonable member fee levels, and sustaining appropriate reserves. Through a combination of these tools, FINRA is committed to maintaining the funding necessary to execute all of its regulatory responsibilities and fulfill our mission of investor protection and market integrity.

We continue to welcome comments or suggestions from our member firms and other relevant stakeholders regarding our financial and transparency initiatives.

Sincerely,



**William H. Heyman**  
Chairman



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

1. **Fund Our Mission** – As a not-for-profit organization, we target break-even cash flows that allow us to appropriately fund our mission of protecting investors and promoting market integrity while facilitating vibrant capital markets. Operating expenses are primarily funded through operating revenues. We rely on our financial reserves (discussed below) to support our mission, and draw upon the principal as needed.
2. **Ensure Financial Transparency** – We publish an Annual Financial Report that is prepared and presented in accordance with GAAP and audited by an independent public accounting firm. We also publish a top-line annual budget that demonstrates our primary sources of income and our primary expenses for the coming year. Following each fiscal year, we provide an accounting of the approved uses of fine monies (discussed below) during that year.
3. **Manage Expenses Responsibly** – We carefully manage expenses while ensuring that we can carry out our regulatory responsibilities effectively.
  - 3.1 **Compensation Oversight** – Our employees are our most important asset. We seek to offer compensation in line with the competitive market in order to attract, develop and retain high-performing individuals who can help us achieve our mission. The Board’s Management Compensation Committee reviews and approves the salary structure and the annual incentive compensation pool for the organization, as well as the individual incentive compensation awards for the most senior executives. Each year, the Committee provides a report that is included in our Annual Financial Report. Although a variety of factors are considered when determining compensation levels for individual employees and the organization as a whole, no compensation determinations are based on fines or other sanctions imposed on the industry.
  - 3.2 **Capital Initiatives Oversight** – Appropriate investments in capital initiatives to enhance our technology and regulatory capabilities are critical to our mission. These projects are non-recurring expenditures that improve the effectiveness and efficiency of our operations; they must undergo a senior management review and approval process, with projects above defined thresholds requiring special approval by the Board or its Finance, Operations and Technology Committee (Finance Committee). These projects fall into several categories:
    - **Capital Maintenance** – Necessary expenditures for items such as building/leasehold improvements or hardware/software (such as servers, storage devices or network equipment).
    - **Mandatory Initiatives** – Regulatory expectations driven by the SEC or other legal, regulatory, audit or contractual requirements; initiatives required by technology obsolescence (such as software no longer supported by vendors); and required infrastructure support (such as cybersecurity improvements).
    - **Carryover Initiatives** – Projects in one of the former categories that carry over from a prior year are evaluated for continued funding.
    - **New Initiatives/Enhancements:**
      - **Minor Enhancements** – Funding to provide capacity for minor enhancements to existing technology (*i.e.*, software improvements).
      - **New Initiatives** – Investments in new systems or technology that will improve our regulatory capabilities or services. These initiatives are assessed for their contribution to our operational efficiency and effectiveness, including their ability to provide demonstrable improvements to the quality of FINRA’s regulatory program, tangible benefits for member firm compliance, or a measurable and acceptable financial return.

4. **Maintain Reasonable Member Fee Levels** – We increase member fees only after evaluating other potential sources of funding (*including* drawing down on excess reserves) and determining that our expenses are appropriately calibrated to our regulatory responsibilities.
5. **Use Fines to Promote Compliance and Improve Markets** – 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. 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 our Sanction Guidelines; fines are not based on revenue considerations, and we do not establish any minimum amount of fines that must be collected for purposes of our annual budget.

Fines collected are accounted for separately, and the use of these monies is subject to special governance procedures, restrictions on use and transparency requirements.

- Any use of fine monies, regardless of amount, must be separately approved by the Board or its Finance Committee. These monies are not considered in determining employee compensation and benefits.
  - The Board or Finance Committee may authorize the use of these funds for: (i) 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; (ii) 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; (iii) capital/initiatives required by new legal, regulatory or audit requirements; or (iv) replenishing reserves (described below) in years where such reserves drop below levels reasonably appropriate to preserve FINRA’s long-term ability to fund its regulatory obligations.
  - On an annual basis, we make public a description of the Board or Finance Committee-approved uses of fine monies during the prior year.
6. **Sustain Appropriate Reserves** – We rely on our financial reserves, which originally derived from the sale of NASDAQ, to support our regulatory mission. We strive to maintain an appropriate level of reserves; currently, the Board believes that level is at least one year of expenditures. Reserves are invested at the direction of the Board’s Investment Committee, which provides a report that is included in our Annual Financial Report. The Board may draw upon the principal as needed, including to cover cash flow losses, defer fee increases, support FINRA’s regulatory operations, enhance member firm compliance or otherwise improve markets.

The FINRA Board will review these Principles on an annual basis.

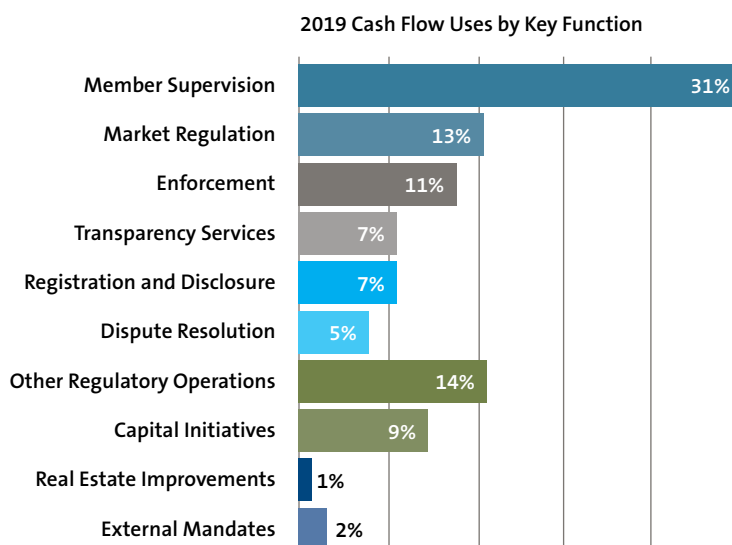
# FINRA 2019 Annual Budget Summary

Budget summaries reflect management's internal reporting framework and differ from U.S. generally accepted accounting principles (GAAP). Annual budgets are subject to change during the year as circumstances arise.

Budget Trend (in millions)	2017 Budget	2018 Budget	2019 Budget <sup>1</sup>
Operating Expenses	\$890.1	\$888.0	\$922.5
Capital Initiatives	\$99.6	\$81.6	\$97.3
Real Estate <sup>2</sup>	\$0.0	\$0.0	\$15.5
External Mandates <sup>3</sup>	\$9.5	\$10.5	\$18.3
<b>Total Cash Flow Uses</b>	<b>\$999.2</b>	<b>\$980.1</b>	<b>\$1,053.5</b>
Operating Revenues	\$828.7	\$822.0	\$846.9
Interest and Dividend Income	\$27.7	\$20.0	\$20.8
Potential Reserve Reliance <sup>4</sup>	\$142.8	\$138.1	\$185.8
<b>Total Cash Flow Sources</b>	<b>\$999.2</b>	<b>\$980.1</b>	<b>\$1,053.5</b>

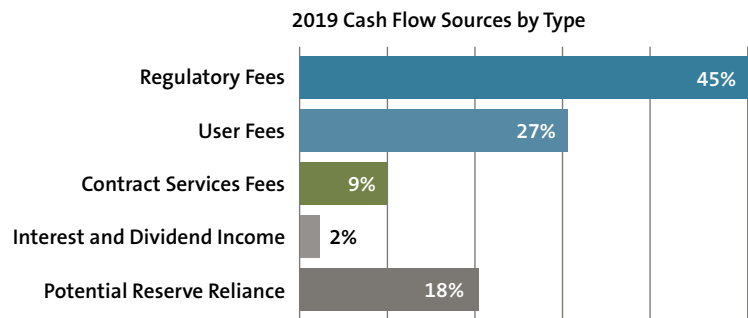
1. The Budget Summary does not include projected revenues or expenses related to the announcement by CAT NMS, LLC, on February 27, 2019, that FINRA has been selected as the plan processor of the Consolidated Audit Trail (CAT).
2. Due to the expiration of existing leases for our New York City office space, we are modifying our footprint in that region and relocating some functions to lower-cost properties. We have budgeted \$15.5 million for relocation costs and related renovations to new and existing office space.
3. External Mandates reflect implementation of the usage of CAT data and the implementation and ongoing support costs for operating the TRACE system as it relates to Treasuries.
4. The Potential Reserve Reliance excludes the impact of any Board-approved use of fine monies and investment gains/losses.

Cash Flow Uses (in millions)	2019
Member Supervision	\$325.2
Market Regulation	\$135.0
Enforcement	\$117.0
Transparency Services	\$78.2
Registration and Disclosure	\$70.6
Dispute Resolution	\$54.4
Other Regulatory Operations <sup>5</sup>	\$142.1
<b>Total Operating Expenses<sup>6</sup></b>	<b>\$922.5</b>
Capital Initiatives	\$97.3
Real Estate Improvements	\$15.5
External Mandates	\$18.3
<b>Total Cash Flow Uses</b>	<b>\$1,053.5</b>



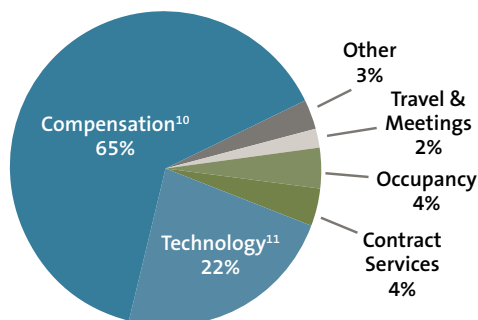
5. Other Regulatory Operations include the Office of General Counsel, the Office of Fraud Detection and Market Intelligence, Advertising Regulation, Corporate Financing, the Office of Hearing Officers, the Office of Member Relations and Education, the Office of Investor Education and other regulatory support functions.
6. Operating Expenses reflect an allocation to each key function for compensation and benefits, contract services, technology and occupancy, as well as costs attributed to other general and administrative services.

Cash Flow Sources (in millions)	2019
Regulatory Fees <sup>7</sup>	\$471.4
User Fees <sup>8</sup>	\$279.8
Contract Services Fees <sup>9</sup>	\$95.8
Total Operating Revenues	\$846.9
Interest and Dividend Income	\$20.8
Potential Reserve Reliance	\$185.8
Total Cash Flow Sources	\$1,053.5

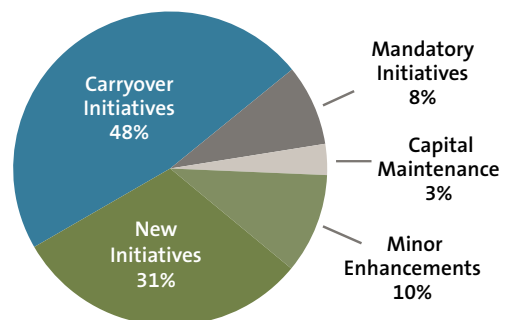


7. Regulatory Fees primarily include the Gross Income Assessment, Personnel Assessment and Trading Activity Fee.
8. User Fees primarily include Registration Fees, Transparency Services Fees, Dispute Resolution Fees, Qualification Fees, Continuing Education Fees, Corporate Financing Fees and Advertising Fees.
9. Contract Services Fees represent amounts charged for regulatory services provided primarily to markets operated by Nasdaq, NYSE, Cboe and other exchanges. These services include surveillance, investigations, examinations and disciplinary work. Contract Services Fees also include fees for the mortgage licensing system FINRA developed and maintains on behalf of the Conference of State Bank Supervisors, and fees for implementing and maintaining the Bluesheets system on behalf of the SEC. Contract Services Fees cover the cost of the services being provided.

Operating Expenses



Capital Initiatives by Type<sup>12</sup>



10. Compensation includes only non-Technology staff.
11. Technology includes costs for employees and contractors; security; and hardware, cloud hosting and software support required to maintain and operate the applications and environments that enable FINRA's regulatory activities.
12. Refer to the Financial Guiding Principles for a description of the different categories of Capital Initiatives.



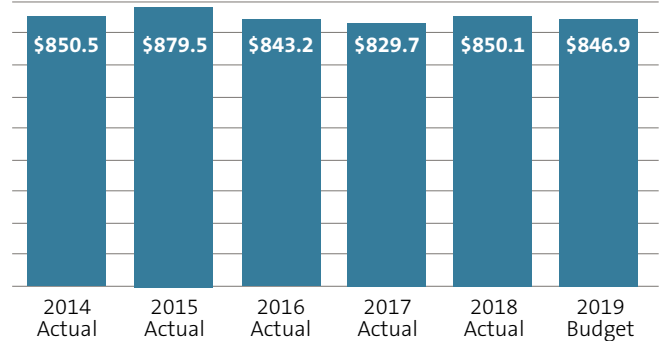
2018 Actuals are preliminary and do not reflect final year-end adjustments.

Historical Trends

**Operating Revenues\***

Operating revenue in 2019 is projected to decline slightly from 2018's. FINRA derives nearly half of its revenues from industry fees that are assessed according to firms' gross revenue and trading volume, as well as firms' total number of registered representatives. Overall revenue generated through these three fees is projected to increase due to higher firm revenues partially offset by lower trading volume. At the same time, user fees, including registration fees and testing fees, are projected to decline. More detail is available on the next page. Total operating revenues for 2014 is net of a \$20 million rebate for members.

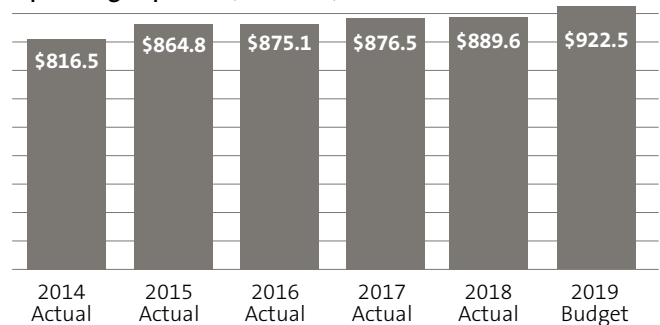
Operating Revenues (in millions)



**Operating Expenses\***

Operating expense increases have stayed largely in line with inflation, at an annual rate of approximately 1.6 percent since 2015. Cost-saving efforts have been driven by managing our compensation costs without compromising our regulatory responsibilities, among other organizational and process improvements. For example, we reduced incentive compensation and held officer salaries flat in 2016, 2017 and 2018. In addition, we have identified and continue to seek further expense reductions and cost saving opportunities, as well as additional efficiencies through FINRA360 and leveraging technology.

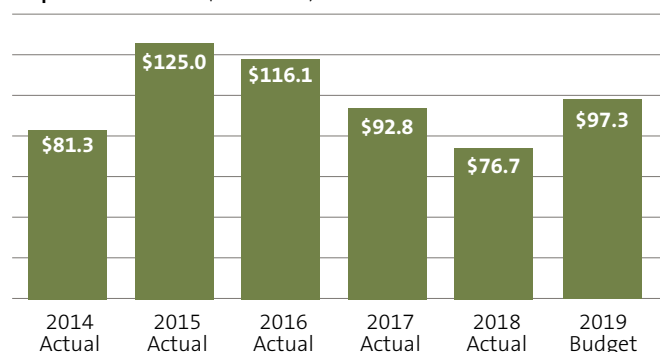
Operating Expenses (in millions)



**Capital Initiatives\***

Capital initiative spending varies from year to year based on the need to enhance regulatory and related technology capabilities. We anticipate capital initiatives of \$97.3 million for 2019, in line with spending over the last five years. The increased spending in 2015 and 2016 was largely due to a decision to migrate FINRA's Market Regulation technology environment from a data center structure to a cloud-based architecture, in addition to the one-time integration of Cboe surveillance patterns and other regulatory tools into the FINRA environment as part of FINRA providing certain services to Cboe. The increased spending in 2019 is in part due to investments in new initiatives, including a transformation of FINRA's externally-facing systems to address areas of significant opportunity for the member firms to reduce compliance costs and facilitate more effective compliance programs.

Capital Initiatives (in millions)



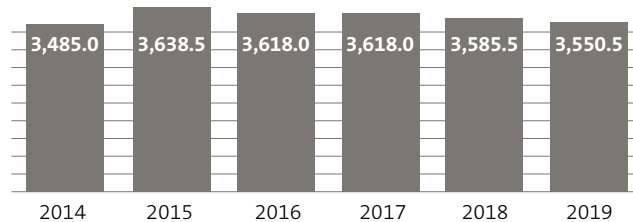
\* Historical results reflect internal management reporting and will differ from GAAP, which includes depreciation and other accounting adjustments.

2018 Actuals are preliminary and do not reflect final year-end adjustments.

## Workforce

FINRA's fluctuations in headcount since 2014 are largely attributable to changes in regulatory services provided to NYSE, Cboe and ORSA. In addition, to manage our workforce more effectively, approximately 120 contractors or temporary employees have been converted to full-time staff in recent years.

Headcount\*



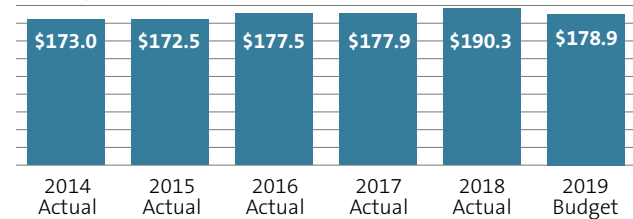
## Historical Operating Revenue Trends

The following provides a five-year look back at the four fees that represent FINRA's largest sources of operating revenue.

### Trading Activity Fee

The Trading Activity Fee is a transaction-based fee that is assessed monthly on firm trading activity in covered securities across all markets.

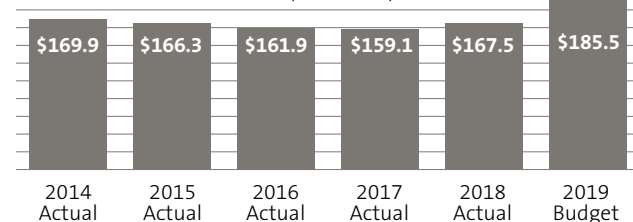
Trading Activity Fee (in millions)



### Gross Income Assessment

The Gross Income Assessment is an annual fee that is assessed based on the firm's prior year's total gross revenue less commodities revenue. The assessment is based on a tiered rate structure that includes provisions that have kept it relatively flat over the past five years.

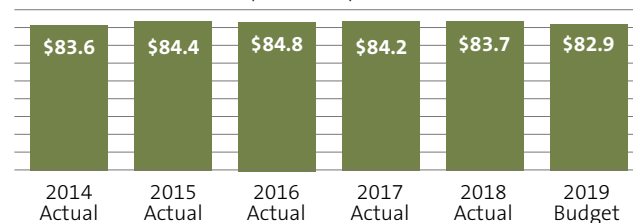
Gross Income Assessment (in millions)



### Personnel Assessment

The Personnel Assessment is an annual fee that is assessed based on the firm's number of registered representatives as of December 31 of the previous year and is applied to a regressive tiered rate structure.

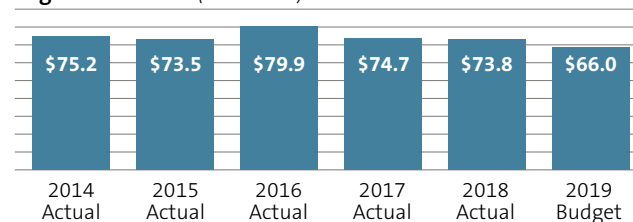
Personnel Assessment (in millions)



### Registration Fees

Registration Fees include fees for various registration-related requirements for firms and registered securities representatives in the industry such as initial registration, fingerprinting, disclosures and terminations.

Registration Fees (in millions)



\* The headcount does not include contractors.

The 2019 budget is allocated according to the following key functions.<sup>13</sup>

## Member Supervision

FINRA's Member Supervision Department (Risk Oversight and Operational Regulation, and Sales Practice) monitors and examines for member compliance with industry rules and regulations.

31%

## Market Regulation

FINRA's Market Regulation Department conducts automated surveillance, examinations and investigations of trading activity in U.S. equities, options and fixed income markets.

13%

## Enforcement

FINRA's Enforcement Department investigates possible misconduct and brings disciplinary actions for violations of industry rules and regulations.

11%

## Transparency Services

FINRA's Transparency Services Department 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.

7%

## Registration and Disclosure

FINRA's Registration and Disclosure Department 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.

7%

## Dispute Resolution

FINRA's Office of Dispute Resolution operates a dispute resolution forum for investors, brokerage firms and their registered employees, and administers arbitrations and mediations through a network of four regional offices, with 70 hearing locations, including one in each state and Puerto Rico.

5%

## Other Initiatives

Other initiatives include capital initiative projects, real estate and external mandates. Capital initiative projects are non-recurring expenditures that improve the effectiveness and efficiency of our operations. Real estate improvements reflect one-time relocation and refurbishment expenses driven by the expiration of existing leases for New York City office space. External mandates reflect implementation of the usage of CAT data and the implementation and ongoing support costs for Treasuries.

12%

13. The 2019 budget by key function represents an allocation of operating expenses for compensation and benefits, contract services, technology and occupancy, as well as costs attributed to other general and administrative services.

## Other Regulatory Operations

14%

FINRA's other regulatory operations include the Office of General Counsel, the Office of Fraud Detection and Market Intelligence, Advertising Regulation, Corporate Financing, the Office of Hearing Officers, the Office of Member Relations and Education, the Office of Investor Education, the Office of the Chief Economist and other regulatory support functions.

FINRA's **Office of General Counsel** assists FINRA in adopting and interpreting rules applicable to securities firms and brokers. FINRA solicits comment on its proposed rules from its members, investors and other interested parties, and, with limited exceptions, all FINRA rules must be approved by the SEC.

The **Office of Fraud Detection and Market Intelligence** centralizes FINRA's review of allegations of serious fraud and significant investor harm, analyzes trading activity across U.S. markets for evidence of insider trading, and analyzes tips and complaints of possible fraud or other misconduct that are submitted to FINRA's Whistleblower hotline or mailbox.

**Advertising Regulation** oversees compliance with rules intended to ensure that member communications to the public are fair, balanced and not misleading.

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

The **Office of Hearing Officers** is an office of impartial adjudicators of disciplinary cases brought by FINRA's Enforcement Department against FINRA members.

The **Office of Member Relations and Education** is responsible for maintaining and enhancing open and effective dialogue with FINRA member firms, and oversees FINRA conferences and the FINRA Institute at Georgetown Certified Regulatory and Compliance Professional program.

The **Office of Investor Education** provides investors with financial tools and resources; and through the FINRA Investor Education Foundation®, FINRA supports important research and financial education initiatives.

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



### FINRA Investor Education Foundation

The Foundation empowers underserved Americans with the knowledge, skills and tools to make sound financial decisions throughout life. The Foundation supports innovative research and educational projects aimed at segments of the investing public that could benefit from additional resources. The Annual Budget Summary does not include the FINRA Foundation. FINRA's Annual Financial Report includes the consolidated results of both FINRA and the Foundation.



Investor protection. Market integrity.

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