FINRA Firm Grouping Member Forum:
Capital Markets & Investment Banking
October 5, 2021 | Virtual

Welcome Remarks and Capital Markets and Investment Banking Common Examination Findings
Tuesday, October 5
10:00 a.m. – 10:45 a.m.

Join FINRA staff as they discuss the most common deficiencies noted during Capital Markets and Investment Banking examinations. Panelists discuss effective practices for preparing for examinations, taking corrective action, annual priorities, trends and updated compliance procedures and practices based on lessons learned from common examination findings. Panelists also share helpful tools and resources available on FINRA.org to manage compliance requirements.

Speaker:
William St. Louis
Senior Vice President, Firm Group Leader – Brookfield Office
FINRA Member Supervision

Moderator:
Thomas Mellett
Vice President, Firm Group Examinations – San Francisco Office
FINRA Member Supervision

Panelists:
Catherine Dunn
Examination Director – Woodbridge Office
FINRA Member Supervision

Stacie Jungling
Director, Risk Monitoring – Denver Office
FINRA Member Supervision

Matthew Reyburn
Director, Risk Monitoring – Chicago Office
FINRA Member Supervision

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Welcome Remarks and Capital Markets and Investment Banking Common Examination Findings Panelist Bios:

Welcome Remarks Speaker:



Bill St. Louis is Senior Vice President and Firm Group Leader for FINRA member firms assigned to the Retail and Capital Markets firm groupings. In this capacity, he has responsibility for the Single Points of Accountability and Risk Monitoring Program teams for these firms, which includes the assessment of business conduct, financial, operational and trading risks. He and his team are also responsible for examination strategy for these firms, as well as coordination with Examination Program management on the execution of related examinations. He also oversees FINRA's High Risk Representative Program, and FINRA's Membership Application Program (MAP). Prior to his current role, Mr. St. Louis was the Regional Director for FINRA's Northeast region, District Director of FINRA's New York office, and held senior roles in FINRA's Enforcement Department including serving as the Regional Chief Counsel for FINRA's North Region. Mr. St. Louis earned an undergraduate degree from Baruch College and a law degree from New York University School of Law. Prior to law school he worked for several years in the Compliance Department of a NY-based broker-dealer.

Moderator:



Thomas Mellett is Head of Capital Markets Examinations for FINRA's Member Supervision department. He is responsible for examinations of FINRA members that are primarily engaged in Capital Markets business activities, including Institutional Private Placements, Investment Banking, Mergers & Acquisitions, Product Origination & Wholesaling, and Public Finance, among others. Prior to this role, Mr. Mellett was the District Director of FINRA's San Francisco District Office, where he was responsible for the office's examination and risk monitoring programs. From 2013 to 2015, Mr. Mellett was a Surveillance Director during which time he supervised regulatory coordinators who planed examinations and conducted risk monitoring of member firms. From 2010 through 2012, Mr. Mellett was an Examination Manager responsible for supervising routine examinations of member firms. He transitioned into management after working as an examiner. Mr. Mellett is designated as a Certified Regulatory and Compliance Professional™ (CRCP™) through the FINRA Institute. Mr. Mellett holds a bachelor's degree in finance from Bentley University.

Panelists:



Catherine Dunn is Examination Director in the Capital Markets Firm Examination Group within FINRA's Member Supervision Department. Ms. Dunn has been in this role since June 2020 and is based in the New Jersey Office. In this position, Ms. Dunn is responsible for leading a team of Examination Managers and Examiners who execute firm examinations. Ms. Dunn was an Examination Manager for 19 years in the New Jersey Office and has been associated with FINRA's Examination Program since joining FINRA in1999. Previously, Ms. Dunn worked at Merrill Lynch as a Senior Accountant in Financial Reporting and as an Auditor in the banking industry. Ms. Dunn has a B.S. in Accounting from Rutgers University.



Stacie Jungling is Risk Monitoring Director for the Capital Market firms whose primary business models are Product Origination and Wholesale and Public Finance. Ms. Jungling has been with FINRA for a decade and has held various roles within Member Supervision. Prior to FINRA, Ms. Jungling worked in the industry as a broker. She received her undergraduate degree from the University of Colorado and her Master of Science in Accounting degree from Regis University. Ms. Jungling also is a Certified Fraud Examiner (CFE) and holds the Certified Regulatory Compliance Professional™ (CRCP™) certificate from the FINRA Institute at Wharton.

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Matt Reyburn is Risk Monitoring Director for the FINRA Capital Markets and Investment Banking grouping. During his 18 years with FINRA, he has served various roles as an Examiner and Examination Manager prior to becoming a Risk Monitoring Director. Mr. Reyburn's experience includes performing examination work through regulatory services agreements for the NASDAQ-LIFFE Single Stock Futures Exchange and Chicago Climate Exchange. As a Risk Monitoring Director, Mr. Reyburn and his team of analysts are responsible for performing the sales practice and financial/operational monitoring of approximately 250 Mergers and Acquisition broker-dealers located across the nation. Prior to joining FINRA, Mr. Reyburn performed various roles including Examination Manager and Strategic Development Analyst at the National Futures Association.

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Welcome Remarks and Capital Markets and Investment Banking Common Examination Findings

Speakers

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  - William St. Louis, Senior Vice President, Firm Group Leader – Brookfield Office, FINRA Member Supervision
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- **Panelists**
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  - Matthew Reyburn, Director, Risk Monitoring – Chicago Office, FINRA Member Supervision

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FINRA

FEBRUARY 2021

2021 Report on FINRA's Examination and Risk Monitoring Program

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Introduction

This Report on FINRA's Risk Monitoring and Examination Activities (the Report) is designed to inform member firms' compliance programs by providing annual insights from FINRA's ongoing regulatory operations. For selected regulatory obligations, the Report: (1) identifies the applicable rule and key related considerations for member firm compliance programs; (2) summarizes noteworthy findings from recent examinations and outlines effective practices that FINRA observed during its oversight; and (3) provides additional resources that may be helpful to member firms.

The Report replaces two of FINRA's prior publications: (1) the Report on FINRA Examination Findings and Observations, which provided an analysis of prior examination results; and (2) the Risk Monitoring and Examination Priorities Letter, which highlighted areas we planned to review in the coming year.

FINRA expects to revisit the Report annually, as we did with these prior publications. Many of the areas addressed in the Report represent ongoing core compliance responsibilities that are reviewed as part of our risk-based exam program each year. Where applicable, we will continue to evolve the information in these areas to address changes in business models, technologies, compliance practices and other factors that may affect how regulatory obligations are fulfilled. Other areas addressed in the Report may be episodic or tied to a particular development, such as a new regulatory requirement or investment product. We expect to include these areas during the periods when they may be most relevant for member firms' compliance programs.

FINRA welcomes feedback on how we can improve future publications of this Report. Please contact Ursula Clay, Senior Vice President, Member Supervision at (646) 315-7375 or by email; or Elena Schlickenmaier, Senior Principal Analyst, Member Supervision, at (202) 728-6920 or by email.

Firms' Practices During COVID-19

In *Regulatory Notice* 20-16 (FINRA Shares Practices Implemented by Firms to Transition to, and Supervise in, a Remote Work Environment During the COVID-19 Pandemic), we shared common themes FINRA noted through discussions with firms about the steps they reported taking in response to the pandemic and in connection with their move to remote work environments. This Report does not address exam findings, observations or effective practices specifically relating to how firms adjusted their operations during the pandemic. Those reviews are underway now and will be addressed in a future publication.

Selected Highlights

This Report addresses several regulatory key topics for each of the four categories: (1) Firm Operations; (2) Communications and Sales; (3) Market Integrity; and (4) Financial Management. As described further in the "How to Use This Report" section below, the importance and relevance of the considerations, findings and effective practices in each of these areas will vary for each member firm.

In general, however, there are several key areas to highlight that impact compliance programs across a large population of member firms:

- **Regulation Best Interest (Reg BI) and Form CRS** – We will continue to focus on assessing whether member firms have established and implemented policies, procedures, and a system of supervision reasonably designed to comply with Reg BI and Form CRS. However, in 2021, we intend to expand the scope of our Reg BI and Form CRS reviews and testing to effect a more comprehensive review of firm processes, practices and conduct. As always, FINRA will take appropriate action in the event we observe conduct that may cause customer harm, would have violated previous standards (*e.g.,* suitability), or indicates a clear disregard of the requirements of Reg BI and Form CRS. In the Reg BI and Form CRS section below, member firms should review considerations our staff will use when examining a firm for compliance with Reg BI and Form CRS. The Report also includes a list of previously published considerations and materials—such as our Reg BI Topic Page.
- **Consolidated Audit Trail (CAT)** – As we noted in *Regulatory Notice* 20-31 (FINRA Reminds Firms of Their Supervisory Responsibilities Relating to CAT), all member firms that receive or originate orders in National Market System (NMS) stocks, over-the-counter (OTC) equity securities or listed options must report to CAT. All proprietary trading activity, including market making activity, is subject to CAT reporting. There are no exclusions or exemptions for size or type of firm or type of trading activity. FINRA is in the early stages of reviewing for compliance with certain CAT obligations; accordingly, exam findings or effective practices are not included in this Report but will be provided later when more information is available. In the interim, member firms should review the list of recommended steps provided in the *Notice* and the list of considerations and relevant resources provided in this Report in assessing the adequacy of their CAT compliance programs.
- **Cybersecurity** – Member firms' ongoing and increasing reliance on technology for many customer-facing activities, communications, trading, operations, back-office and compliance programs—especially in our current remote work environment—requires them to address new and existing cybersecurity risks, including risks relating to cybersecurity-enabled fraud and crime. A firm's cybersecurity program should be reasonably designed and tailored to the firm's risk profile, business model and scale of operations. FINRA reminds firms that we review cybersecurity programs for compliance with business continuity plan requirements, as well as the SEC's Regulation S-P Rule 30, which requires member firms to have policies and procedures addressing the protection of customer records and information. Given the increase in remote work and virtual client interactions, combined with an increase in cyber-related crimes, we encourage member firms to review the considerations, observations and effective practices noted in the Report, as well as *Regulatory Notice* 20-13 (FINRA Reminds Firms to Beware of Fraud During the Coronavirus (COVID-19) Pandemic), Report on Selected Cybersecurity Practices – 2018 and Report on Cybersecurity Practices – 2015.
- **Communications with the Public** – FINRA continues to evaluate member firms for compliance with FINRA Rule 2210 (Communications with the Public), which includes principles-based content standards that are designed to apply to ongoing developments in communications technology and practices. In addition, we are increasingly focused on communications relating to certain new products, and how member firms supervise, comply with recordkeeping obligations, and address risks relating to new digital communication channels. This focus includes risks associated with app-based platforms with interactive or "game-like" features that are intended to influence customers, their related forms of marketing, and the appropriateness of the activity that they are approving clients to undertake through those platforms (*e.g.,* under FINRA Rule 2360 (Options)). The Report also addresses the communications relating to cash management services that sweep customer cash into affiliate or partner

banks or money market funds (Cash Management Accounts). As always, we remain focused on reviewing member firms' communications relating to complex products, as well as the information firms convey to senior and vulnerable investors.

- **Best Execution** – FINRA has routinely reviewed member firms for their compliance with best execution obligations under FINRA Rule 5310 (Best Execution and Interpositioning) in our examinations. Among other things, FINRA has continued to focus on potential conflicts of interest in order-routing decisions, appropriate policies and procedures for different order and security types, and the sufficiency of member firms' reviews of execution quality. We also conducted a targeted review of member firms that do not charge commissions for customer transactions ("zero commission" trading) to evaluate the impact that not charging commissions has or will have on member firms' order-routing practices and decisions, and other aspects of member firms' business. In addition to general compliance considerations, findings and effective practices from our examination program, the Report also includes themes we noted in the "zero commission" targeted review.
- **Variable Annuities** – FINRA continues to evaluate variable annuity exchanges under FINRA Rule 2330 (Members' Responsibilities Regarding Deferred Variable Annuities) and, when applicable, under Reg BI. Additionally, in early 2020, we engaged in an informal review of buyout written supervisory procedures (WSPs), training, and disclosures for member firms whose customers were impacted by a recent announcement from an insurer with sizable variable annuity assets stating it will terminate servicing agreements, cancel certain trail commissions for registered representatives, and provide buyout offers to its variable annuity customers. In addition to reviewing considerations and findings provided in the Report, we encourage member firms to consider the effective practices we identified as part of this particular review.

How to Use the Report

FINRA's Risk Monitoring and Examination Programs evaluate member firms for compliance with relevant obligations and consider specific risks relating to each firm, including those relating to a firm's business model, supervisory control system and prior exam findings, among other considerations. While the topics addressed in this Report are selected for their interest to the largest number of member firms, they may include areas that are not relevant to an individual member firm and omit other areas that are applicable.

FINRA advises each member firm to review the Report and consider incorporating relevant practices into its compliance programs in a manner tailored to its activities. The Report is intended to be just one of the tools a member firm can use to help inform the development and operation of its compliance program; it does not represent a complete inventory of regulatory obligations, compliance considerations, examination findings, effective practices or topics that FINRA will examine.

FINRA also reminds member firms to stay apprised of new or amended laws, rules and regulations, and to update their WSPs and compliance programs on an ongoing basis, as new regulatory obligations may be part of future examinations. FINRA encourages member firms to reach out to their designated Risk Monitoring Analyst if they have any questions about the considerations, findings and effective practices described in this Report.

Each area of regulatory obligations is set forth as follows:

- **Regulatory Obligations and Related Considerations** – A brief description of:
  - relevant federal securities laws, regulations and FINRA rules; and
  - questions FINRA may ask or consider when examining your firm for compliance with such obligations. We encourage member firms to use these questions, if applicable, when evaluating their compliance programs and related controls, and preparing for FINRA examinations.

- **Exam Findings and Effective Practices**
  - Noteworthy findings that FINRA has noted at some—but not all—member firms, including:
    - new findings from recent examinations;
    - findings we highlighted in the 2017, 2018 and 2019 Exam Findings Reports, and continue to note in recent examinations;
    - in certain sections, topics noted as "Emerging Risks" representing potentially concerning practices that FINRA has observed and which may receive increased scrutiny going forward; and
    - for certain topics, such as Cybersecurity, Liquidity Management and Credit Risk, observations that suggested improvements to a firm's control environment to address potential weaknesses that elevate risk, but for which there are not specific rule violations.
  - Select effective practices FINRA observed in recent exams, as well as those we noted in prior Exam Findings Reports and which we continue to see, that may help member firms, depending on their business model, evaluate their own programs.

Supervision

We do not address supervisory deficiencies or practices in a separate Supervision topic, but rather, address them as part of the underlying regulatory obligation (*e.g.,* supervisory shortcomings relating to annuity exchanges are addressed in the Variable Annuities section).

Senior and Vulnerable Investors

We also do not include a separate section on senior or vulnerable investors because FINRA considers such investors when evaluating firms' compliance programs for many of the topics addressed in this Report, including determining the egregiousness of an exam finding or rule violation. FINRA remains highly focused on, and committed to, protecting senior and vulnerable investors, and takes this into consideration when evaluating communications, recommendations of certain products, and sales practice conduct.

- **Additional Resources** – A list of relevant FINRA Notices, other reports, tools and online resources.

The Report also includes an Appendix that outlines how member firms have used similar FINRA reports (Exam Findings Reports or Priorities Letters) in their compliance programs.

As a reminder, the Report—like our previous Exam Findings Reports and Priorities Letters—does not create any new legal or regulatory requirements or new interpretations of existing requirements. You should not infer that FINRA requires member firms to implement any specific practices described in this report extend beyond the requirements of existing federal securities rules and regulations or FINRA rules.

Firm Operations

Anti-Money Laundering

Regulatory Obligations and Related Considerations

Regulatory Obligations

The Bank Secrecy Act (BSA) requires firms to monitor for, detect and report suspicious activity conducted or attempted by, at, or through the firms to the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN). Firms should also be aware of the recently enacted Anti-Money Laundering Act of 2020, which may result in material revisions to the implementing regulations over time.

FINRA Rule 3310 (Anti-Money Laundering Compliance Program) requires that members develop and implement a written anti-money laundering (AML) program reasonably designed to comply with the requirements of the BSA and its implementing regulations. Additionally, FinCEN's Customer Due Diligence (CDD) rule requires that firms identify beneficial owners of legal entity customers, understand the nature and purpose of customer accounts, and conduct ongoing monitoring of customer accounts to identify and report suspicious transactions and—on a risk basis—update customer information.

Related Considerations

- How does your firm's AML compliance program address new business lines, products, customers and risks?
- Does your firm tailor and adequately resource their AML program to the firm's business model and associated AML risks?
- Does your firm's independent testing confirm that it maintains appropriate risk-based procedures for collecting and verifying customer identification information on all individuals and entities that would be considered customers under the Customer Identification Program rule, and beneficial owners of legal entity customers under the CDD rule?
- Does your firm review the integrity of its data feeds for its surveillance and monitoring programs?
- How does your firm coordinate with your clearing firm, including with respect to the filing of joint suspicious activity reports?
- Does your firm document the results of its reviews and investigations into potentially suspicious activity identified by exception reports?

Exam Findings and Effective Practices

Exam Findings

- **Inadequate AML Transaction Monitoring** – Not tailoring transaction monitoring to address firms' business risk(s).
- **Limited Scope for Suspicious Activity Reports (SARs)** – Not requiring staff to notify AML departments or file SARs for a range of events involving suspicious transactions, such as financial crime-related events, including but not limited to cybersecurity events, account compromises, account takeovers, new account fraud and fraudulent wires.

- **Inadequate AML Framework for Cash Management Accounts** – Failing to incorporate, or account for, in their AML programs, the AML risks relating to Cash Management Accounts, including the following:
  - monitoring, investigating and reporting suspicious money movements;
  - a list of red flags in their WSPs indicative of potentially suspicious transactions; or
  - expanding or enhancing their AML compliance program resources to address Cash Management Accounts.
- **Unclear Delegation of AML Responsibilities** – Non-AML staff (*e.g.,* business line staff responsible for trade surveillance) failing to escalate suspicious activity monitoring alerts to AML departments because firms did not: (1) clearly define the activities that were being delegated; (2) articulate those delegations and related surveillance responsibilities in their WSPs; or (3) train non-AML staff on AML surveillance policies and procedures.
- **Data Integrity Gaps** – Excluding certain types of data and customer accounts from monitoring programs as a result of problems with ingesting certain data, inaccuracies and missing information in data feeds.
- **Failure to Document Investigations** – Not documenting initial reviews and investigations into potentially suspicious activities identified by SARs.
- **Concerns About High-Risk Trading by Foreign Legal Entity Accounts** – Inadequate identification of or follow-up on increased trading by foreign legal entity accounts in similar low-float and low-priced securities, which raised concerns about potential ownership or control by similar beneficial owners.
- **Insufficient Independent Testing** – Not reviewing how the firm's AML program was implemented; not ensuring independence of the testing; and not completing tests on an annual calendar year basis.
- **Improper Reliance on Clearing Firms** – Introducing firms relying primarily or entirely on their clearing firms for transaction monitoring and suspicious activity reporting, even though they are required to monitor for suspicious activity attempted or conducted through their firms.

Emerging AML and Other Financial Crime Risks

Microcap and Other Fraud

Some firms continue to engage in fraud, financial crimes and other problematic practices, such as those described in the SEC Staff Bulletin: Risks Associated with Omnibus Accounts Transacting in Low-Priced Securities, which addresses microcap and penny stock activity transacted in omnibus accounts maintained for foreign financial institutions and foreign affiliates of U.S. broker-dealers.

Issuers Based in Restricted Markets

Certain foreign national and foreign entity nominee accounts appear to have been opened solely to invest in the initial public offerings and subsequent aftermarket trading in one or more exchange-listed issuers based in restricted markets, such as China. FINRA has observed red flags that the owners of the accounts may be acting at the direction of others, multiple accounts being opened using the same foreign bank for the source of funds or multiple accounts with the same employer and same email domain. The trading activity may include multiple similar limit orders being placed by the accounts at the same time, which could be indicative of coordinated and manipulative trading of the issuers' securities.

Risks Relating to Special Purpose Acquisition Companies (SPACs)

Some firms are engaging in the formation and initial public offerings (IPOs) of SPACs without having adequate WSPs that would require independently conducting due diligence of SPACs' sponsors, and procedures that address other potential fraud risks, including but not limited to:

- misrepresentations and omissions in offerings documents and communications with shareholders regarding SPAC acquisition targets, such as the prospects of the target company and its financial condition;
- fees associated with SPAC transactions, including cash and non-cash compensation and compensation earned by affiliates;
- control of funds raised in SPAC offerings; and
- insider trading (where underwriters and SPAC sponsors may possess and trade around material non-public information regarding potential SPAC acquisition targets, including private placement offerings with rights of first refusal provided to certain investors prior to the acquisition).

Effective Practices

- **Customer Identification Program** – Using, on a risk-basis, both documentary (such as drivers' licenses or passports) and non-documentary methods (such as using third-party sources) to verify customers' identities.
- **Monitoring for Fraud During Account Opening** – Implementing additional precautions during account opening, including limiting automated approval of multiple accounts opened by a single customer; reviewing account application fields for repetition or commonalities among multiple applications; and using technology to detect indicators of automated scripted attacks in the digital account application process.
- **Bank Account Verification, Restrictions on Fund Transfers and Ongoing Monitoring** – Confirming customers' identities through verbal confirmation, following client verification protocols or using a third-party verification service, such as Early Warning System (EWS); monitoring of outbound money movement requests post-ACH set-up; restricting fund transfers in certain situations; and conducting ongoing monitoring of accounts.
- **Collaboration With Clearing Firms** – Understanding the allocation of responsibilities between clearing and introducing firms for handling ACH transactions; and implementing policies and procedures to comply with those responsibilities.

- **AML Compliance Tests** – Confirming annual AML independent tests evaluate the adequacy of firms' AML compliance programs, review firms' SAR reporting processes, and include sampling and transaction testing of firms' monitoring programs.
- **Risk Assessments** – Updating risk assessments based on the results of AML independent tests, audits, and changes in size or risk profile of the firms, including their businesses, registered representatives and customer account types; and using AML risk assessments to inform the focus of firms' independent AML tests.
- **Testing of Transaction Monitoring and Model Validation** – Performing regular, ongoing testing and tuning of transaction monitoring models, scenarios and thresholds; and confirming the integrity of transaction monitoring data feeds and validating models (which are more frequently used at large firms).
- **Collaboration with AML Department** – Increasing the likelihood that all potentially reportable events are referred to the AML department by establishing a line of communication (such as reporting and escalation processes, awareness and educational programs, regular meetings, policies and procedures, or exception reports) between the AML department and other departments that may observe potentially reportable events (such as registered representatives and client-facing teams, technology, cybersecurity, compliance, operations, trading desks and fraud departments).
- **Training Programs** – Designing training programs for each of the roles and responsibilities of the AML department (as well as departments that regularly work with AML) and addressing all AML regulatory and industry developments.

Additional Resources

- *Regulatory Notice* 20-13 (FINRA Reminds Firms to Beware of Fraud During the Coronavirus (COVID-19) Pandemic)
- *Regulatory Notice* 19-18 (FINRA Provides Guidance to Firms Regarding Suspicious Activity Monitoring and Reporting Obligations)
- SEC Staff Bulletin: Risks Associated with Omnibus Accounts Transacting in Low-Priced Securities
- Anti-Money Laundering (AML) Template for Small Firms
- Frequently Asked Questions (FAQ) Regarding Anti-Money Laundering (AML)
- Anti-Money Laundering (AML) Topic Page

Cybersecurity and Technology Governance

Regulatory Obligations and Related Considerations

Regulatory Obligations

The SEC's Regulation S-P Rule 30 requires firms to have written policies and procedures that are reasonably designed to safeguard customer records and information. FINRA Rule 4370 (Business Continuity Plans and Emergency Contact Information) also applies to denials of service and other interruptions to members' operations. In addition to firms' compliance with SEC regulations, FINRA reminds firms that cybersecurity remains one of the principal operational risks facing broker-dealers, and expects firms to develop reasonably designed cybersecurity programs and controls that are consistent with their risk profile, business model and scale of operations.

Technology-related problems, such as problems in firms' change- and problem-management practices, can expose firms to operational failures that may compromise firms' ability to comply with a range of rules and regulations, including FINRA Rules 4370 (Business Continuity Plans and Emergency Contact Information), 3110 (Supervision) and 4511 (General Requirements), as well as Securities Exchange Act of 1934 (Exchange Act) Rules 17a-3 and 17a-4.

Related Considerations

- What kind of governance structure has your firm developed to identify and respond to cybersecurity risks?
- What is the scope of your firm's Data Loss Prevention program, including encryption controls?
- How does your firm address branch-specific cybersecurity risks?
- What kind of training does your firm conduct on cybersecurity, including phishing?
- What process does your firm have to evaluate your firm's vendors' cybersecurity controls?
- Has your firm implemented multi-factor authentication (MFA) or other relevant access management controls?
- What controls does your firm implement to mitigate system capacity performance and integrity issues that may undermine its ability to conduct business and operations, monitor risk or report key information?
- How does your firm document system change requests and approvals?
- What type of testing does your firm perform prior to changes being moved into a production environment and post-implementation?
- What are your firm's procedures for tracking information technology problems and their remediation? Does your firm categorize problems based on their business impact?

Exam Observations and Effective Practices

Exam Observations

- **Data Loss Prevention Programs** – Not encrypting all confidential data, including a broad range of non-public customer information in addition to Social Security numbers (such as other account profile information and firm information).
- **Branch Policies, Controls and Inspections** – Not maintaining branch-level written cybersecurity policies; inventories of branch-level data, software and hardware assets; and branch-level inspection and automated monitoring programs.
- **Training** – Not providing comprehensive training to registered representatives, personnel, third-party providers and consultants on cybersecurity risks relevant to individuals' roles and responsibilities, including phishing.
- **Vendor Controls** – Not implementing and documenting formal policies and procedures to review prospective and existing vendors' cybersecurity controls and managing the lifecycle of firms' engagement with all vendors (*i.e.,* from onboarding, to ongoing monitoring, through off-boarding, including defining how vendors will dispose of non-public client information).
- **Access Management** – Not implementing access controls, including developing a "policy of least privilege" to grant system and data access only when required and removing it when no longer needed; not limiting and tracking individuals with administrator access; and not implementing MFA for registered representatives, employees, vendors and contractors.
- **Inadequate Change Management Supervision** – Insufficient supervisory oversight for application and technology changes (including upgrades, modifications to or integration of firm or vendor systems), which lead to violations of other regulatory obligations, such as those relating to data integrity, cybersecurity, books and records, and confirmations.
- **Limited Testing and System Capacity** – Order management system, account access and trading algorithm malfunctions due to a lack of testing for changes or system capacity issues.

Emerging Cybersecurity Risks

FINRA recently observed increased numbers of cybersecurity- or technology-related incidents at firms, including:

- systemwide outages;
- email and account takeovers;
- fraudulent wire requests;
- imposter websites; and
- ransomware.

We also noted data breaches at some firms and remain concerned about increased risks for firms that do not implement practices to address phishing emails or require MFA for accessing non-public information.

We remind firms to review the practices noted below, as well as the materials noted in the associated Additional Resources section.

Effective Practices

- **Insider Threat and Risk Management** – Collaborating across technology, risk, compliance, fraud, and internal investigations/conduct departments to assess key risk areas, monitor access and entitlements, and investigate potential violations of firm rules or policies with regard to data access or data accumulation.
- **Incident Response Planning** – Establishing and regularly testing written formal incident response plans that outlined procedures for responding to cybersecurity and information security incidents; and developing frameworks to identify, classify, prioritize, track and close cybersecurity-related incidents.
- **System Patching** – Implementing timely application of system security patches to critical firm resources (*e.g.,* servers, network routers, desktops, laptops and software systems) to protect non-public client or firm information.
- **Asset Inventory** – Creating and keeping current an inventory of critical information technology assets—including hardware, software and data—as well as corresponding cybersecurity controls.
- **Change Management Processes** – Implementing change management procedures to document, review, prioritize, test, approve, and manage hardware and software changes, as well as system capacity, in order to protect non-public information and firm services.

Additional Resources

- *Regulatory Notice* 20-32 (FINRA Reminds Firms to Be Aware of Fraudulent Options Trading in Connection With Potential Account Takeovers and New Account Fraud)
- *Information Notice* 03/26/20 (Measures to Consider as Firms Respond to the Coronavirus Pandemic (COVID-19))
- *Regulatory Notice* 20-13 (FINRA Reminds Firms to Beware of Fraud During the Coronavirus (COVID-19) Pandemic)
- Report on Selected Cybersecurity Practices – 2018
- Report on Cybersecurity Practices – 2015
- Small Firm Cybersecurity Checklist
- Core Cybersecurity Controls for Small Firms
- Customer Information Protection Topic Page
- Cybersecurity Topic Page
- Non-FINRA Cybersecurity Resources

Outside Business Activities and Private Securities Transactions

Regulatory Obligations and Related Considerations

Regulatory Obligations

FINRA Rules 3270 (Outside Business Activities of Registered Persons) and 3280 (Private Securities Transactions of an Associated Person) require registered representatives to notify their firms in writing of proposed outside business activities (OBAs), and all associated persons to notify their firms in writing of proposed private securities transactions (PSTs), so firms can determine whether to limit or allow those activities. A firm approving a PST where the associated person has or may receive selling compensation must record and supervise the transaction as if it were executed on behalf of the firm.

Related Considerations

- Do your firm's WSPs explicitly state where notification or pre-approval is required to engage in an OBA or PST?
- Does your firm require associated persons or registered persons to complete and update, as needed, questionnaires and attestations regarding their involvement—or potential involvement—in OBAs and PSTs; and if yes, how often?
- Do you have a process in place in to update a registered representative's Form U4 with OBAs that meet the disclosure requirements of that form?
- What methods does your firm use to identify individuals involved in undisclosed OBAs and PSTs?
- Does your firm take into account the unique regulatory considerations and characteristics of digital assets when reviewing digital asset OBAs and PSTs?
- How does your firm supervise PSTs, including digital asset PSTs, and document its compliance with the supervisory obligations?
- Does your firm record the PSTs on its books and records, including PSTs involving new or unique products and services?

Exam Findings and Effective Practices

Exam Findings

- **Incorrect Interpretation of Requirements** – Interpreting "compensation" too narrowly (by focusing on only direct compensation, such as salary or commissions, rather than evaluating all direct and indirect financial benefits from PSTs, such as membership interests, receipt of preferred stock and tax benefits); and, as a result, erroneously determining that certain activities were not PSTs, or approving participation in proposed transactions without adequately considering whether the firms need to supervise the transaction as if it were executed on their own behalf.
- **No Documentation** – Not retaining the documentation necessary to demonstrate firms' compliance with the supervisory obligations for PSTs and not recording the transactions on the firm's books and records because certain PSTs were not consistent with firms' electronic systems (such as where securities businesses conducted by a registered representative would not be captured in their clearing firm's feed of purchases and sales activity).
- **No or Insufficient Notice and Notice Reviews** – Registered persons failing to notify their firms in writing of OBAs or PSTs; and WSPs not requiring the review of such notices, or the documentation that such reviews had taken place.

- **No PST Monitoring** – Not monitoring limitations placed on OBAs or PSTs, such as prohibiting registered representatives from soliciting firm clients to participate in the OBA or PST.
- **No Review and Recordkeeping of Digital Asset Activities** – Incorrectly assuming all digital assets are not securities and, therefore, not evaluating digital asset activities, including activities performed by affiliates, to determine whether they are PSTs; and for certain digital asset or other activities that were deemed to be PSTs because registered representatives received selling compensation, not supervising such activities or recording such transactions on the firm's books and records.

Emerging OBA/PST Risks

Paycheck Protection Program (PPP) Loans for Registered Representatives

FINRA noted that some registered representatives received a PPP loan for an OBA that had not been disclosed to their firms, and which may have required an update to their Form U4 as well. Firms should consider reviewing the publicly available data on PPP loans to determine if they have a registered representative who obtained a PPP loan for an undisclosed OBA.

Effective Practices

- **Questionnaires** – Requiring registered representatives and other associated persons to complete upon hire, and periodically thereafter, detailed, open-ended questionnaires with regular attestations regarding their involvement —or potential involvement—in new or previously disclosed OBAs and PSTs (including asking questions relating to any other businesses where they are owners or employees; whether they are raising money for any outside activity; whether they act as "finders"; and any expected revenues or other payments they receive from any entities other than member firms, including affiliates).
- **Thorough Reviews** – Conducting reviews to learn about all OBAs and PSTs at the time of a registered representative's initial disclosure to the firm and periodically thereafter, including thorough reviews of:
  - social media, professional networking and other publicly available websites and other sources (such as legal research databases and court records);
  - email, social media and other communications;
  - interviews with registered representatives; and
  - documentation supporting the activity (such as organizational documents).
- **Monitoring** – Monitoring significant changes in or other red flags relating to registered representatives' or associated persons' performance, production levels, or lifestyle that may indicate involvement in undisclosed or prohibited OBAs and PSTs (or other business or financial arrangements with their customers, such as borrowing or lending), including conducting regular, periodic background checks and reviews of:
  - correspondence (including social media);
  - fund movements;
  - marketing materials;
  - online activities;
  - customer complaints; and
  - financial records (including bank statements and tax returns).

- **Affiliate Activities** – Considering whether registered representatives' and other associated persons' activities with affiliates, especially self-offerings, may implicate FINRA Rules 3270 and 3280.
- **WSPs** – Clearly identifying types of activities or investments that would constitute an OBA or PST subject to disclosure/approval or not, as well as defining compensation, and in some cases, providing FAQs to remind employees of scenarios that they might not otherwise consider applicable to these rules.
- **Training** – Conducting training on OBAs and PSTs during onboarding and periodically thereafter, including regular reminders that registered representatives must give written notice of such activities to their firms and update their disclosures.
- **Disciplinary Action** – Imposing significant consequences—including heightened supervision, fines or termination—for registered representatives and associated persons who fail to notify firms in writing and receive approval for their OBAs and PSTs.
- **Digital Asset Checklists** – Creating checklists with a list of considerations to confirm whether digital asset activities would be considered OBAs or PSTs (including reviewing private placement memoranda or other materials and analyzing the underlying products and investment vehicle structures).

Additional Resources

- *Regulatory Notice* 20-23 (FINRA Encourages Firms to Notify FINRA if They Engage in Activities Related to Digital Assets)
- *Regulatory Notice* 18-08 (FINRA Requests Comment on Proposed New Rule Governing Outside Business Activities and Private Securities Transactions)
- *Notice to Members* 96-33 (NASD Clarifies Rules Governing RRs/IAs)
- *Notice to Members* 94-44 (Board Approves Clarification on Applicability of Article III, Section 40 of Rules of Fair Practice to Investment Advisory Activities of Registered Representatives)

Books and Records

Regulatory Obligations and Related Considerations

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) (collectively, Books and Records Rules) 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."

Such records must be immediately produced or reproduced and may be maintained and preserved for the required time on electronic storage media (ESM) subject to the conditions set forth in Exchange Act Rule 17a-4(f)(2) (ESM Standards), including "non-rewriteable and non-erasable format." Firms must also provide notification to FINRA as required by Exchange Act Rule 17a-4(f)(2)(i), including a representation that the selected storage media meets the conditions of Exchange Act Rule 17a-4(f)(2) and a third-party attestation as set forth in Exchange Act Rule 17a-4(f)(3)(vii) (collectively, ESM Notification Requirements).

Related Considerations

- What kind of vendors, such as cloud service providers (Cloud Vendors), does your firm use to comply with Books and Records Rule requirements, including storing required records on ESM? How does it confirm compliance with the Books and Records Rules, ESM Standards and ESM Notification Requirements?
- Has your firm reviewed its Books and Records Rule policies and procedures to confirm they address all vendors, including Cloud Vendors?

Exam Findings and Effective Practices

Exam Findings

- **Misinterpreted Obligations** – Not performing due diligence to verify vendors' ability to comply with Books and Records Rules requirements if they use that vendor; or not confirming that service contracts and agreements comply with ESM Notification Requirements, because they did not understand that all required records must comply with the Books and Records Rules, including records stored using Cloud Vendors' storage services.
- **No ESM Notification** – Not complying with the ESM Notification Requirements, including obtaining the third-party attestation letters required by Exchange Act Rule 17a-4(f)(3)(vii).

Effective Practices

- **Contract Review** – Reviewing vendors' contracts and agreements to assess whether firms will be able to comply with the Books and Records Rules, ESM Standards and ESM Notification Requirements.
- **Testing and Verification** – Testing all vendors'—including Cloud Vendors'—capabilities to fulfill regulatory obligations by, for example, simulating a regulator's examinations by requesting records, and engaging regulatory or compliance consultants to confirm compliance with the Books and Records Rule, ESM Standards and ESM Notification Requirements (and, in some cases, engaging the consultant to provide the third-party attestation).
- **Attestation Verification** – Confirming with vendors, including Cloud Vendors, whether the firms or the vendors will provide the third-party attestation.

Additional Resources

- Frequently Asked Questions about the Amendments to Broker/Dealer Books and Records Rules Under the Securities Exchange Act of 1934
- Books and Records Requirements Checklist
- Books and Records Topic Page

Regulatory Events Reporting

Regulatory Obligations and Related Considerations

Regulatory Obligations

FINRA Rule 4530 (Reporting Requirements) requires firms to promptly report to FINRA, and associated persons to promptly report to firms, specified events, including, for example, violations of securities laws and FINRA rules, certain written customer complaints and certain disciplinary actions taken by the firm. Firms must also report quarterly to FINRA statistical and summary information regarding certain written customer complaints.

Related Considerations

- Do your firm's WSPs require associated persons to report written customer complaints, judgments, liens and other events to the firm's compliance department?
- Does your firm provide periodic reminders or training on such requirements, and what consequences does your firm impose on those persons that do not comply?
- How does your firm monitor for red flags of unreported written customer complaints and other reportable events?
- How does your firm ensure that it accurately and timely reports to FINRA written customer complaints that associated persons reported to your firm's compliance department?
- How does your firm determine the problem and product codes it uses for its statistical reporting of written customer complaints to FINRA?

Exam Findings and Effective Practices

Exam Findings

- **No Reporting to the Firm** – Associated persons not reporting complaints, judgments, liens and other events to the firms' compliance departments because they were not aware of firm requirements;
- **Inadequate Surveillance** – Firms not conducting regular email and other surveillance for unreported events.
- **No Reporting to FINRA** – Failing to report to FINRA written customer complaints that associated persons reported to the firms' compliance departments.
- **Incorrect Rule 4530 Product/Problem Codes** – As part of the statistical reporting to FINRA, failing to use codes that correlated to the most prominent product or the most egregious problem alleged in the written customer complaints, but instead, reporting less prominent or severe codes or other codes based on the firms' investigations or other information.

Effective Practices

- **Compliance Questionnaires** – Developing detailed annual compliance questionnaires to verify the accuracy of associated persons' disclosures, including follow-up questions (such as whether they have ever filed for bankruptcy, have any pending lawsuits, are subject to an unsatisfied judgments or liens, or received any written customer complaints).
- **Email Surveillance** – Conducting email surveillance targeted to identify unreported complaints (by, for example, including complaint-related words in their keyword lexicons, reviewing for unknown email addresses, and conducting random email checks).
- **Review of Registered Representatives' Financial Condition** – Identifying expenses, settlements and other payments that may indicate unreported events by conducting periodic reviews of their associated persons' financial condition, including background checks and credit reports.
- **Review of Publicly Available Information** – Conducting periodic searches of associated persons' names on web forums, court filings and other publicly available databases, including reviewing for any judgments, liens and other reportable events.

Additional Resources

- *Regulatory Notice* 20-17 (FINRA Revises Rule 4530 Problem Codes for Reporting Customer Complaints and for Filing Documents Online)
- *Regulatory Notice* 20-02 (FINRA Requests Comment on the Effectiveness and Efficiency of Its Reporting Requirements Rule)
- *Regulatory Notice* 15-05 (SEC Approves Consolidated FINRA Rule Regarding Background Checks on Registration Applicants)
- *Regulatory Notice* 13-08 (FINRA Amends Rule 4530 to Eliminate Duplicative Reporting and Provide the Option to File Required Documents Online Using a New Form)
- FINRA's Rule 4530 Reporting Requirements
- FINRA's Rule 4530 Reporting Codes
- FINRA Report Center – 4530 Disclosure Timeliness Report Card

Fixed Income Mark-up Disclosure

Regulatory Obligations and Related Considerations

Regulatory Obligations

Since 2018, FINRA's and the Municipal Securities Rulemaking Board's (MSRB) amendments to FINRA Rule 2232 (Customer Confirmations) and MSRB Rule G-15 have required firms to provide additional transaction-related information to retail customers for certain trades in corporate, agency and municipal debt securities (other than municipal fund securities). Disclosed mark-ups and mark-downs must be expressed as both a total dollar amount for the transaction and a percentage of prevailing market price (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.

Related Considerations

- What are the frequency, scope and depth of your firm's review of the accuracy of your firm's confirmations, and does it include reviewing samples of confirmations?
- How does your firm work with its clearing firm(s) to ensure the accuracy of your firm's confirmations?
- Is the process to ensure mark-up disclosures appear on confirmations manual or automated?
- What is the scope of diligence and oversight your firm conducts on customer confirmation vendors?
- Has your firm considered how to maintain consistent and correct disclosures for fixed income transactions executed across different vendors, platforms or trading desks?

Exam Findings and Effective Practices

Exam Findings

- **Incorrect PMP Determinations** – Adjusting the PMP in firms' order entry systems to subtract registered representatives' concession or sales credit from the mark-up; PMP not presumptively relying on the dealer's contemporaneous cost or proceeds; deciding that firms' costs or proceeds were no longer "contemporaneous" without sufficient evidence as required by FINRA Rule 2121.02(b)(4) and using other pricing information to determine the PMP.
- **Incorrect Compensation Disclosures** – Disclosing additional charges separately from disclosed mark-ups or mark-downs, even when such charges reflected firm compensation; disclosing 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; inaccurately labeling only the sales credits or concessions portion as the total mark-up or mark-down.
- **Failure to Provide Accurate Time of Execution** – Disclosing 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).
- **Disclosure for Structured Notes** – Failing to provide disclosures on customer confirmations for trades in TRACE-reportable structured notes because firms did not realize the notes were subject to FINRA Rule 2232 or did not receive the PMP from the structured note distributors.
- **Incorrect Designation of Institutional Accounts** – Failing to provide disclosures to certain customers because the firm identified those customers' accounts as "institutional," even though the customers did not meet the "institutional" definition in FINRA Rule 4512(c) (Customer Account Information) or MSRB Rule G-8(a)(xi).

Effective Practices

- **Confirmation Review** – Performing regular reviews of confirmations, including samples of confirmations, to confirm the accuracy of all disclosures, including all of the required disclosure elements, including the mark-up or mark-down, the time of execution and the security-specific link (with CUSIP).
- **Collaborating With Clearing Firms** – For correspondent firms, engaging with clearing firms to understand their policies and processes for providing mark-up disclosure.
- **Due Diligence of Vendors** – Conducting due diligence into customer confirmation vendors' processes and methodology to determine PMP.
- **Product and Customer Review** – Reviewing firm confirmation systems and processes to confirm that they cover all products and customers subject to FINRA Rule 2232 (in particular, whether they accurately categorize "institutional" customers using the definition in FINRA Rule 4512(c) or MSRB Rule G-8(a)(xi)).

Additional Resources

- *Regulatory Notice* 17-24 (FINRA Issues Guidance on the Enhanced Confirmation Disclosure Requirements in Rule 2232 for Corporate and Agency Debt 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

Communications and Sales

Reg BI and Form CRS

Regulatory Obligations and Related Considerations

Regulatory Obligations

Reg BI establishes a "best interest" standard of conduct for broker-dealers and associated persons when they make a recommendation to retail customers of any securities transaction or investment strategy involving securities, including recommendations of types of accounts.

Broker-dealers are also required to provide a brief relationship summary, Form CRS, to retail investors on the types of client and customer relationship and services the firm offers; the fees, costs, conflicts of interest, and required standard of conduct associated with those relationships and services; whether the firm and its financial professionals currently have reportable legal or disciplinary history; and how to obtain additional information about the firm.

Related Considerations

- Does your firm have policies, procedures and controls in place to assess recommendations using a best interest standard?
- Do your firm and your associated persons apply a best interest standard to recommendations of types of accounts and recommendations to roll over or transfer assets from one type of account to another?
- Do your firm's policies, procedures and controls continue to address compliance with FINRA Rule 2111 (Suitability), which still applies to recommendations made to non-retail investors?
- Does your firm have policies, procedures and controls addressing Reg BI's recordkeeping requirements?
- Has you firm provided adequate Reg BI training to its sales and supervisory staff?
- Do your firm and your associated persons consider the express new elements of care, skill and costs when making recommendations to retail customers?
- Do your firm and your associated persons consider reasonably available alternatives to the recommendation?
- Do your firm and your registered representatives guard against excessive trading, irrespective of whether the broker-dealer or associated person "controls" the account?
- Does your firm have policies and procedures to provide the disclosures required by Reg BI?
- Does the firm place any material limitations on the securities or investment strategies involving securities that may be recommended to a retail customer, and if so, does the firm address and disclose such limitations?
- Does your firm have policies and procedures to identify and address conflicts of interest?
- If the firm is not dually registered as an investment adviser, commodity advisor or municipal advisor, does the firm or any of its associated persons who are not dually registered advisors or advisory representatives use "adviser" or "advisor" in their name or title?
- Does your firm have policies, procedures and controls in place regarding the filing, updating and delivery of Form CRS?
- Does your firm's Form CRS accurately respond to the disciplinary history question with regard to the firm and its financial professionals?
- If your firm has a website, has it posted its Form CRS in a prominent location on that website?
- Does your firm's Form CRS include required conversation starters, headers and prescribed language?

Exam Findings and Effective Practices

As FINRA is in the early stages of reviewing for compliance with these new obligations, this Report will not include exam findings or effective practices relating to Reg BI and Form CRS. FINRA notes that the SEC held a virtual Roundtable on Regulation Best Interest and Form CRS that discussed some early examination findings. We anticipate issuing a separate publication in the future after more exams have been conducted. FINRA reminds firms to review the materials noted in the Additional Resources section below.

Additional Resources

- *Regulatory Notice 20-18* (FINRA Amends Its Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest)
- *Regulatory Notice 20-17* (FINRA Revises Rule 4530 Problem Codes for Reporting Customer Complaints and for Filing Documents Online)
- FINRA Highlights Firm Practices from Regulation Best Interest Preparedness Reviews
- SEC's Regulation Best Interest, Form CRS and Related Interpretations
- FINRA's Regulation Best Interest (Reg BI) Topic Page

Communications with the Public

Regulatory Obligations and Related Considerations

Regulatory Obligations

FINRA Rule 2210 (Communications with the Public) categorizes all communications into three categories—correspondence, retail communications or institutional communications—and sets principles-based content standards that are designed to apply to ongoing developments in communications technology and practices. The rule also includes standards for firms' approval, review and recordkeeping procedures, as well as requirements to file certain communications with FINRA. FINRA Rule 2210 requires, among other things, that all communications be based on principles of fair dealing and good faith, be fair and balanced, provide a sound basis for evaluating the facts "in regard to any particular security or type of security, industry, or service" and include all "material fact[s] or qualification[s]" necessary to ensure such communications are not misleading. In addition, the rule prohibits false, misleading, promissory or exaggerated statements or claims, and projections of performance.

Related Considerations

- **General Standards**
  - Do your firm's communications include material information necessary to make them fair, balanced and not misleading? For example, if a communication promotes the benefits of a high-risk or illiquid security, does it explain the associated risks?
  - Do your firm's communications balance specific claims of investment benefits from a securities product or service (especially complex products) with the key risks specific to that product or service?
  - Do your firm's communications contain false, misleading or promissory statements or claims?
  - Do your firm's communications contain predictions or projections of investment performance to investors that are generally prohibited by FINRA Rule 2210(d)(1)(F)?

- **Digital Communication Channels**
  - Does your firm's digital communication policy address all permitted and prohibited digital communication channels and features available to your customers and associated persons?
  - Does your firm review for red flags that may indicate a registered representative is communicating through unapproved communication channels, and does your firm follow up on such red flags? For example, red flags might include email chains that copy unapproved representative email addresses, references in emails to communications that occurred outside approved firm channels, or customer complaints mentioning such communications.
  - How does your firm supervise and maintain books and records in accordance with SEC and FINRA rules for all approved digital communications?
  - If your firm offers an app to customers that includes an interactive element, does the information provided to customers constitute a "recommendation" that would be covered by Reg BI, which requires a broker-dealer to act in a retail customer's "best interest," or suitability obligations under FINRA Rule 2360 (Options)? If so, how does your firm comply with these obligations?
  - If your firm's app platform design includes "game-like" aspects that are intended to influence customers to engage in certain trading or other activities, how does your firm address and disclose the associated potential risks to your customers?
  - Do your firm's communications—regardless of the platform through which they are made—comply with the content standards set forth in FINRA Rule 2210?
- **Digital Asset Communications** – If your firm or an affiliate engages in digital asset activities:
  - Does your firm provide a fair and balanced presentation in marketing materials and retail communications, including addressing risks presented by digital asset investments, and not misrepresenting the extent to which digital assets are regulated by FINRA or the federal securities laws or eligible for protections thereunder, such as Securities Investor Protection Corporation (SIPC) coverage?
  - Do your firm's communications misleadingly imply that digital asset services offered through an affiliated entity are offered through and under the supervision, clearance and custody of a registered broker-dealer?
- **Cash Management Accounts Communications** – If your firm offers Cash Management Accounts, does it:
  - Clearly communicate the terms of the Cash Management Accounts?
  - Disclose that the Cash Management Accounts' deposits are obligations of the destination bank, and not cash balances held by your firm?
  - Confirm that its communications do not state or imply that:
    - brokerage accounts are similar to, or the same, as bank "checking and savings accounts" or other a ccounts insured by the Federal Deposit Insurance Corporation (FDIC); and
    - FDIC insurance coverage applies to funds when held at or by a registered broker-dealer?
  - Review whether communications fairly explain the:
    - nature and structure of the program;
    - relationship of the brokerage accounts to any partner banks in the Cash Management Accounts;
    - amount of time it may take for customer funds to reach the bank accounts; and
    - risks of participating in such programs?

Exam Findings and Effective Practices

Exam Findings

- **Deficient Digital Assets Communications** – Failing to balance promotional statements with prominent risk disclosures; including false, misleading or unwarranted statements; using the same firm names, websites and other materials for broker-dealers and their digital asset affiliates; not identifying the (non-broker-dealer) entities responsible for digital asset offerings; and implying that digital assets were offered by the broker-dealer.
- **Misrepresentations in Cash Management Accounts Communications** – Misrepresenting material information relating to Cash Management Accounts in online and other communications (in some cases, despite written and verbal warnings from FINRA's Advertising Regulation Department), including, for example, the firms' status as broker-dealers rather than banks; the status of Cash Management Accounts as "checking and savings accounts;" the amount of FDIC insurance coverage for the deposits; the amount of time it may take for customer funds to reach the bank accounts; terms of the Cash Management Accounts; and risks of participating in such programs.
- **Insufficient Supervision and Recordkeeping for Digital Communication** – Not maintaining policies and procedures to reasonably identify and respond to red flags—such as customer complaints, representatives' email, OBA reviews or advertising reviews—that registered representatives used impermissible business-related digital communications methods, including texting, messaging, social media, collaboration apps or "electronic sales seminars" in chatrooms.
- **No WSPs and Controls for Communication That Use Non-Member or OBA Names (so-called "Doing Business As" or "DBA" Names)** – Not maintaining WSPs to identify the broker-dealer clearly and prominently as the entity through which securities were offered in firm communications, such as websites, social media posts, seminars or emails that promote or discuss the broker-dealer's securities business and identify a non-member entity, such as a representative's OBA; and not including a "readily apparent reference" and hyperlink to FINRA's BrokerCheck in such communications.

Emerging Digital Communication Risks

New Digital Platforms With Interactive and "Game-Like" Features

2020 witnessed a surge in new retail investors entering the markets via online brokers, as well as an increase in certain types of trading, including options. Some online broker-dealers' apps—as well as those offered by other financial services and consumer-oriented businesses—include interactive and "game-like" features, as well as related forms of advertising and marketing. Such features affect many aspects of how firms interact and communicate with customers, from initial advertisements through the opening of accounts, recommendations and the presentation of different investment choices.

While such features may improve customers' access to firm systems and investment products, they may also result in increased risks to customers if not designed with the appropriate compliance considerations in mind. Firms must evaluate these features to determine whether they meet regulatory obligations to:

- comply with any Reg BI and Form CRS requirements if any communications constitute a "recommendation" that requires a broker-dealer to act in a retail customer's "best interest";
- make disclosures relating to risks to customers, fees, costs, conflicts of interest, and required standards of conduct associated with the firm's relationships and services;
- prohibit the use of false, exaggerated or misleading statements or claims in any communications and ensure all firm communications are fair and balanced and do not omit material information concerning products or services;
- comply with account opening requirements that require firms to gather information about customers (such as FINRA Rule 4512 (Customer Account Information)) and approve certain types of accounts, including options accounts (such as FINRA Rule 2360(b)(16) (Diligence in Opening Accounts) and other supervisory controls relating to options, such as surveilling for optionsrelated customer complaints, excessive commissions and fees, and large amounts of losses);
- develop a comprehensive supervisory system for such communication methods, including surveilling for red flags of potential violative behavior and maintaining books and records of all communications related to the firm's business as such; and
- address compliance with FINRA communications rules, such as FINRA Rules 2210 (Communications with the Public); 2211 (Communications with the Public About Variable Life Insurance and Variable Annuities); 2212 (Use of Investment Company Rankings in Retail Communications); 2213 (Requirements for the Use of Bond Mutual Fund Volatility Ratings); 2214 (Requirements for Use of Investment Analysis Tools); 2215 (Communications with the Public Regarding Securities Futures); 2216 (Communications with the Public Regarding Collateralized Mortgage Obligations) and 2220 (Options Communications).

Effective Practices

- **Comprehensive Procedures for Digital Communications** – Maintaining and implementing procedures for firm digital communication channel policies, including:
  - **Monitoring of New Tools and Features** – Marketing, compliance and information technology departments working closely together, as well as with third-party vendors, to monitor new communication channels, apps and features available to their associated persons and customers.
  - **Defining and Enforcing What is Permissible and Prohibited** – Clearly defining permissible and prohibited digital communication channels, and blocking prohibited channels, tools or features, including those that prevent firms from complying with their recordkeeping requirements.
  - **Supervision** – Implementing supervisory review procedures tailored to each digital channel, tool and feature.
  - **Video Content Protocols** – Developing WSPs and controls for live-streamed public appearances, scripted presentations or video blogs.
  - **Training** – Implementing mandatory training programs prior to providing access to firm-approved digital channels, including expectations for business and personal digital communications and guidance for using all permitted features of each channel.
  - **Disciplinary Action** – Temporarily suspending or permanently blocking from certain digital channels or features those registered representatives who did not comply with the policies and requiring additional digital communications training.
- **Digital Asset Communications** – Maintaining and implementing procedures for firm digital asset communications, including:
  - **Risk Disclosure** – Prominently describing the risks associated with digital assets, including that such investments are speculative, involve a high degree of risk, are generally illiquid, may have no value, have limited regulatory certainty, are subject to potential market manipulation risks and may expose investors to loss of principal.
  - **Communication Review** – Reviewing firms' communications to confirm that they were not exaggerating the potential benefits of digital assets or overstating the current or future status of digital asset projects or platforms.
  - **Communication to Differentiate Digital Assets From Broker-Dealer Products** – Identifying, segregating and differentiating firms' broker-dealer products and services from those offered by affiliates or third parties, including digital asset affiliates; and clearly and prominently identifying entities responsible for non-securities digital assets businesses (and explaining that such services were not offered by the broker-dealer or subject to the same regulatory protections as those available for securities).
- **Reviews of Firms' Capabilities for Cash Management Accounts** – Requiring new product groups or departments to conduct an additional review for proposed Cash Management Accounts to confirm that the firms' existing business processes, supervisory systems and compliance programs—especially those relating to communications—can support such programs.
- **Use of Non-Member or OBA Names (so-called DBAs)** – Maintaining and implementing procedures for OBA names, including:
  - **Training** – Providing training on relevant FINRA rules and firm policies, and requiring annual attestations to demonstrate compliance with such requirements.
  - **Templates** – Requiring use of firm-approved vendors to create content or standardized templates populated with approved content and disclosures for all OBA communications (including websites, social media, digital content or other communications) that also concern the broker-dealer's securities business.

- **Prior Approval** – Prohibiting the use of OBA communications that concern the broker-dealer's securities business without prior approval by compliance, and creating a centralized system for the review and approval of such communications, including content and disclosures.
- **Notification and Monitoring** – Requiring registered representatives to notify compliance of any changes to approved communications, and conducting periodic, at least annual, monitoring and review of previously approved communications for changes and updates.

Additional Resources

- *Regulatory Notice* 20-23 (FINRA Encourages Firms to Notify FINRA if They Engage in Activities Related to Digital Assets)
- *Regulatory Notice* 20-21 (FINRA Provides Guidance on Retail Communications Concerning Private Placement Offerings)
- *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)
- *Regulatory Notice* 11-39 (Social Media Websites and the Use of Personal Devices for Business Communications)
- *Regulatory Notice* 10-06 (Guidance on Blogs and Social Networking Web Sites)
- Advertising Regulation Topic Page
- Social Media Topic Page

Private Placements

Regulatory Obligations and Related Considerations

Regulatory Obligations

As noted in *Regulatory Notice* 10-22 (Obligations of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings), as part of their obligations under FINRA Rule 2111 (Suitability) and supervisory requirements under FINRA Rule 3110 (Supervision), firms must conduct a "reasonable investigation" by evaluating "the issuer and its management; the business prospects of the issuer; the assets held by or to be acquired by the issuer; the claims being made; and the intended use of proceeds of the offering." The SEC's Reg BI became effective on June 30, 2020, and would apply to recommendations of private offerings to retail customers. Reg BI similarly requires, among other things, a broker-dealer to exercise reasonable diligence, care and skill to understand the potential risks, rewards and costs associated with a private offering recommendation and have a reasonable basis to believe that the private offering recommendation could be in the best interest of at least some retail customers.

In addition, firms must make timely filings for specified private placement offerings with FINRA's Corporate Financing Department under FINRA Rules 5122 (Private Placements of Securities Issued by Members) and 5123 (Private Placements of Securities).

Related Considerations

- What policies and procedures does your firm have to address filing requirements and timelines under FINRA Rules 5122 and 5123? How does it review for compliance with such policies?
- How does your firm use and evaluate consultants, experts or other third-party vendors' due diligence reports?

- How does your firm conduct reasonable investigations on private placement offerings, including conducting further inquiry into red flags identified during the reasonable investigation process?
- How does your firm address conflicts of interest identified in third-party due diligence reports?
- How does your firm handle escrowed funds and amended terms in contingency offerings?
- If your firm is engaging in new business, such as Regulation A offerings or SPACs, has it implemented WSPs to address this business? If this business may constitute a material change in your firm's business operations, has your firm considered whether it needs to file a Continuing Membership Application (CMA)?

Exam Findings and Effective Practices

Exam Findings

- **Late Filings** – Not having policies and procedures, processes and supervisory programs to comply with filing requirements; and failing to make timely filings (with, in some cases, delays lasting as long as six to twelve months after the offering closing date).
- **No Reasonable Investigation** – Failing to perform reasonable investigations of private placement offerings prior to recommending the offerings to retail investors, including failing to conduct additional research about new offerings, relying on their experience with the same issuer in previous offerings and not conducing further inquiry into red flags identified during the investigation process.
- **Concerning Third-Party Due Diligence** – Failing to address red flags (such as disciplinary history of the issuer's management), conflicts of interest (such as undisclosed direct or indirect common ownership of affiliated entities or the issuer) or significant concerns (such as no legitimate operating history for the issuer) identified in third-party due diligence reports.

Effective Practices

- **Private Placement Checklist** – Creating checklists with—or added to existing firm Regulation D and other offering checklists—all steps, filing dates, related documentation requirements and evidence of supervisory principal approval for the filing requirements of FINRA Rules 5122 and 5123.
- **Independent Research** – Conducting and documenting independent research on material aspects of the offering; identifying any red flags with the offering or the issuer (such as questionable business plans or unlikely projections or results); and addressing and, if possible, resolving concerns that would be relevant to a potential investor (such as tax considerations or liquidity restrictions).
- **Independent Verification** – Verifying information that was key to the performance of the offering (such as unrealistic costs projected to execute the business plan coupled with aggressively projected timing and overall rate of return for investors); and, in some cases, receiving support from due diligence firms, experts and third-party vendors.
- **Mitigating Conflicts of Interest** – Using firms' reasonable investigation processes to mitigate conflicts of interest and developing comprehensive disclosures for offerings involving firm affiliates or issuers whose control persons were also employed by the firm.
- **Ownership for Filings** – Assigning responsibility for private placement filing requirements to specific individual(s) or team(s) and conducting targeted, in-depth training about the firms' policies, process and technical filing requirements.
- **Automated Alert System** – Creating an automated system that alerts responsible individual(s) and supervisory principal(s) about upcoming and missed filing deadlines.

- **Private Placement Committee** – Creating a private placement committee (at larger firms) or formally designating one or more qualified persons (at smaller firms); charging committee-designated individuals with investigating and determining whether to approve the offering for sale to investors; and conducting research and identifying and highlighting red flags with the offering or the issuer.
- **Post-Approval Processes** – Using the investigation analysis to establish post-approval processes and investment limits based on the complexity or risk level of the offering.
- **Ongoing Monitoring** – Conducting ongoing monitoring after the offering to ascertain whether offering proceeds were used in a manner consistent with the offering memorandum, particularly for ongoing sales of an offering after initial closing.

Additional Resources

- *Regulatory Notice* 20-21 (FINRA Provides Guidance on Retail Communications Concerning Private Placement Offerings)
- *Regulatory Notice* 10-22 (Obligations of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings)
- Report Center – Corporate Financing Report Cards
- FAQs about Private Placements
- Corporate Financing Private Placement Filing System User Guide
- Private Placements Topic Page

Variable Annuities

Regulatory Obligations and Related Considerations

Regulatory Obligations

FINRA Rule 2330 (Members' Responsibilities Regarding Deferred Variable Annuities) establishes sales practice standards regarding recommended purchases and exchanges of deferred variable annuities, including requiring a reasonable belief that the customer has been informed of the various features of annuities (such as surrender charges, potential tax penalties, various fees and costs, and market risk); and, prior to recommending the purchase or exchange of a deferred variable annuity, requiring reasonable efforts to determine the customer's age, annual income, investment experience, investment objectives, investment time horizon, existing assets and risk tolerance. To the extent that a broker-dealer or associated person is recommending a purchase or exchange of a deferred variable annuity to a retail customer, Reg BI's obligations, discussed above, also would apply.

In addition, the rule requires that firms conduct surveillance to determine if any associated person is effecting deferred variable annuity exchanges at a rate that might suggest conduct inconsistent with FINRA Rule 2330. Firms must also have procedures to implement corrective action to address any exchanges and conduct that violate FINRA Rule 2330.

Related Considerations

- How does your firm review for rates of variable annuity exchanges (*i.e.,* does your firm use any automated tools, exception reports or surveillance reports)?
- Does your firm have standardized review thresholds for rates of variable annuity exchanges?

- Does your firm have a process to confirm its variable annuity data integrity (including general product information, share class, riders and exchange-based activity) and engage with affiliate and non-affiliate insurance carriers to address inconsistencies in available data, data formats and reporting processes for variable annuities?
- What is your firm's process to supervise buyout offers (*i.e.,* does it include pre-approval, exception reports and post-transaction reviews)?
- What do your WSPs require registered representatives to do in order to support a determination that a transaction meets the standard of care requirements and that there is a reasonable basis for it? What is the manner in which they are to obtain, evaluate and record such information such as whether a customer would incur a surrender charge; would be subject to a new surrender period; would lose existing benefits; would be subject to increased fees or charges; would invest a substantial portion of the customer's liquid net worth in the variable annuity; has liquidity needs that are inconsistent with the variable annuity; would be investing in a share class that is not in the customer's best interest given his or her financial needs, time horizon and riders included with the contract; and has had another exchange within the preceding 36 months?
- Do your firm's policies and procedures require registered representatives to inform customers of the various features of annuities, such as surrender charges, potential tax penalties, various fees and costs, and market risk?
- How do your firm's registered principals supervise variable annuity transactions, including verifying how the customer would benefit from certain features of deferred variable annuities, such as tax-deferral, annuitization, or a death or living benefit? What processes, forms, documents and information do the firm's registered principals rely on to make such determinations?
- Does your firm have WSPs to address when it decides to stop selling or retires certain products, or opens buyout or exchange periods, including, but not limited to: how it will handle the product termination process; how it decides whether it offers an exchange or buyout; the scope of its exposure (in terms of contracts and customers); how it will notify customers and registered representatives; and how it will monitor for exchange rates?

Exam Findings and Effective Practices

Exam Findings

- **Not Addressing Buyouts** – Not addressing within firms' systems of supervision (by having applicable WSPs, delivering training, or making appropriate disclosures, etc.) that customers accepting buyouts may be losing valuable benefits associated with their existing products, subject to new surrender charge periods, and paying higher fees and expenses with new products (as was the case when customers were impacted by a recent announcement that an insurer with sizable variable annuity assets will terminate servicing agreements, cancel certain trail commissions for registered representatives, and provide buyout offers to its variable annuity customers).
- **Unsuitable Exchanges** – Not reasonably supervising recommendations of exchanges that were inconsistent with the customer's objectives and time horizon and resulted in, among other consequences, increased fees to the customer or the loss of material, paid-for accrued benefits.
- **Inadequate Source of Funds Review** – Not performing sufficient review of source of funds used to purchase new variable annuities.
- **Insufficient Training** – Not conducting training for registered representatives and supervisors regarding how to assess fees, surrender charges and long-term income riders to determine whether exchanges were suitable for customers.

Effective Practices

Buyout Offers

- **Policies and Reviews** – Performing a holistic review of buyout offers; requiring supervisory principal pre-approval (and, in some cases, additional second-level approval) for buyout offers; and requiring registered representatives' recommendations to consider all changes to customers' variable annuities, such as possible surrender charges, loss of benefits, contract values, riders, cash surrender values, expenses and fees.
- **Training** – Providing extensive, ongoing training and communications to all registered representatives about buyout offers and related compliance obligations (including, in some cases, creating dedicated firm telephone or chat helplines).
- **Conflicts of Interest** – Addressing and mitigating potential conflicts of interest for registered representatives who may recommend that customers pursue buyout offers to free up proceeds for new investments or variable annuity exchanges by, for example, leveling registered representatives' compensation for buyout offers, exchanges or new investments.
- **Additional Disclosures** – Developing new buyout offer disclosures or expanding existing variable annuity disclosure forms to address considerations for buyout offers.
- **Additional Post-Transaction Review** – Creating additional exception reports and conducting additional transaction monitoring for those customers who accepted buyout offers to confirm that those transactions were submitted for supervisory principal pre-approval (and, where required, additional second-level approval) and, if not, evaluating for compliance with FINRA Rule 2330.

Exchanges

- **Automated Surveillance** – Using automated tools, exception reports and surveillance to review variable annuity exchanges, and implementing second-level supervision of supervisory reviews of exchange-related exception reports and account applications.
- **Rationales** – Requiring registered representatives to provide detailed written rationales for variable annuity exchanges for each customer (including confirming that such rationales address the specific circumstances for each customer and do not replicate rationales provided for other customers); and requiring supervisory principals to verify the information provided by registered representatives, including product fees, costs, rider benefits and existing product values.
- **Review Thresholds** – Standardizing review thresholds for rates of variable annuity exchanges; and monitoring for emerging trends across registered representatives, customers, products and branches.
- **Data Integrity** – Creating automated (rather than manual) solutions to synthesize variable annuity data (including general product information, share class, riders and exchange-based activity) and engaging with affiliated and non-affiliated insurance carriers to address inconsistencies in available data, data formats and reporting processes for variable annuities.

Additional Resources

- *Regulatory Notice* 20-18 (FINRA Amends Its Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest)
- *Regulatory Notice* 20-17 (FINRA Revises Rule 4530 Problem Codes for Reporting Customer Complaints and for Filing Documents Online)
- *Regulatory Notice* 10-05 (FINRA Reminds Firms of Their Responsibilities Under FINRA Rule 2330 for Recommended Purchases or Exchanges of Deferred Variable Annuities)

- *Notice to Members* 07-06 (Special Considerations When Supervising Recommendations of Newly Associated Registered Representatives to Replace Mutual Funds and Variable Products)
- *Notice to Members* 99-35 (The NASD Reminds Members of Their Responsibilities Regarding the Sales of Variable Annuities)
- Variable Annuities Topic Page
- SEC's Regulation Best Interest, Form CRS and Related Interpretations
- FINRA's Regulation Best Interest (Reg BI) Topic Page

Market Integrity

CAT

Regulatory Obligations and Related Considerations

Regulatory Obligations

FINRA and the national securities exchanges have adopted rules requiring their members to comply with Exchange Act Rule 613 and the CAT NMS Plan FINRA Rule 6800 Series (Consolidated Audit Trail Compliance Rule) (collectively, CAT Rules), which cover reporting to the CAT; clock synchronization; time stamps; connectivity and data transmission; development and testing; recordkeeping; the timeliness, accuracy and completeness of data; and compliance dates. *Regulatory Notice 20-31* (FINRA Reminds Firms of Their Supervisory Responsibilities Relating to CAT) describes certain practices and recommended steps firms should consider when developing and implementing their CAT Rules compliance program.

Related Considerations

- Do your firm's CAT Rules WSPs, at a minimum: (1) identify the individual, by name or title, responsible for the review of CAT reporting; (2) describe specifically what type of review(s) will be conducted of the data posted on the CAT Reporter Portal; (3) specify how often the review(s) will be conducted; and (4) describe how the review(s) will be evidenced?
- How does your firm confirm that the data reported by your firm or on your firm's behalf is transmitted in a timely fashion and is complete and accurate?
- How does your firm determine how and when clocks are synchronized, who is responsible for clock synchronization, how your firm evidences that clocks have been synchronized, and how the firm will self-report clock synchronization violations?
- Does your firm conduct daily reviews of the Industry Member CAT Reporter Portal (CAT Reporter Portal) to, among other requirements, review file status to ensure the file(s) sent by the member or by their reporting agent was accepted by CAT and to identify/address any file submission or integrity errors?
- Does your firm conduct periodic comparative reviews of accepted CAT data against order and trade records and the CAT Reporting Technical Specifications?
- Does your firm communicate regularly with your CAT reporting agent, review relevant CAT guidance and announcements, and report CAT reporting issues to the FINRA CAT Help Desk?

Exam Findings and Effective Practices

As FINRA is in the early stages of reviewing for compliance with certain CAT Rules obligations, this Report does not include exam findings or effective practices relating to CAT Rules. FINRA reminds firms to review the materials noted in the Additional Resources section below.

Additional Resources

- *Regulatory Notice 19-19* (FINRA Reminds Firms to Register for CAT Reporting by June 27, 2019)
- *Regulatory Notice 17-09* (The National Securities Exchanges and FINRA Issue Joint Guidance on Clock Synchronization and Certification Requirements Under the CAT NMS Plan)
- CAT NMS Plan
- Consolidated Audit Trail (CAT) Topic Page

Best Execution

Regulatory Obligations and Related Considerations

Regulatory Obligations

FINRA Rule 5310 (Best Execution and Interpositioning) requires that, in any transaction for or with a customer or a customer of another broker-dealer, a member and persons associated with a member shall use reasonable diligence to ascertain the best market for the subject security, and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. Firms must conduct a "regular and rigorous" review of the execution quality of customer orders if the firm does not conduct an order-by-order review. 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 material differences in execution quality among the markets that trade the securities under review, it should modify its routing arrangements or justify why it is not doing so.

Related Considerations

- How does your firm determine whether to employ order-by-order or "regular and rigorous" reviews of execution quality?
- How does your firm implement and conduct an adequate "regular and rigorous" review of the quality of the executions of its customers' orders?
- How does your firm document its "regular and rigorous" reviews, the data and other information considered, order routing decisions and the rationale used, and address any deficiencies?
- How does your firm address potential conflicts of interest in order-routing decisions, including those relating to its routing of orders to affiliated alternative trading systems (ATSs), affiliated broker-dealers, or affiliated exchange members? When routing orders to an affiliate, how does your firm ensure that its order-routing decisions are based upon best execution considerations and not unduly influenced by these affiliations?
- How does your firm address potential conflicts of interest in order-routing decisions, including those related to its routing of orders to market centers that provide payment for order flow (PFOF) or other-routing inducements?
- When routing to market centers that provide PFOF or other inducements, how does your firm ensure that its order-routing decisions are based upon best execution considerations and not unduly influenced by these economic incentives?
- If your firm engages in fixed income and options trading, has it established targeted controls to perform its best execution obligations for these products? Does your firm consider differences among security types within these products, such as the different characteristics and liquidity of U.S. Treasury securities compared to other fixed income securities?
- Does your firm perform its best execution obligations with respect to trading conducted in both regular and extended trading hours?
- Does your firm consider the risk of information leakage when assessing the execution quality of orders routed to a particular venue?
- What data sources does your firm use for its routing decisions and execution quality reviews for different order types and sizes, including odd lots?
- How does your firm handle fractional share investing in the context of its best execution obligations?

Exam Findings and Effective Practices

Exam Findings

- **No Assessment of Execution vs. Competing Markets** – Not comparing the quality of the execution obtained via firms' existing order-routing and execution arrangements against the quality of execution they could have obtained from competing markets.
- **No Review of Certain Order Types** – Not conducting 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** – Not considering certain factors set forth in FINRA Rule 5310 when conducting a "regular and rigorous review," including, among other things, speed of execution, price improvement and the likelihood of execution of limit orders; and using routing logic that was not necessarily based on quality of execution.
- **Conflicts of Interest** – Not considering and addressing potential conflicts of interest relating to routing of orders to affiliated broker-dealers, ATSs or market centers that provide PFOF or other routing inducements, such as PFOF from wholesale market makers and exchange liquidity rebates.
- **Inadequate SEC Rule 606 Disclosures** – Not providing material disclosures in order-routing reports, such as the specific, material aspects of the non-directed order flow routed to firms' trading desks, including that they stand to share in 100 percent of the profits generated by their trading as principal with their customers' orders; material aspects of their relationships with each of the significant venues identified on their reports, including descriptions and terms of all arrangements for PFOF (including the amounts of PFOF on a per share or per order basis) and profit-sharing relationships that may have influenced the firms' order routing decisions.

Targeted Examination Letter on Zero Commissions

As part of FINRA's ongoing 2020 targeted review of firms' decisions to move to "zero-commission" trading, we are evaluating:

- whether the "zero-commission" model adversely affected firms' compliance with their best execution obligations;
- how firms used other practices, such as Cash Management Accounts and PFOF, to potentially offset lost commission revenue; and
- whether firms prominently communicated restrictions and limitations of "zero-commission" structures and other fees charged to customers.

We will share the findings from this targeted review with member firms in a future publication once the review is complete.

Effective Practices

- **Exception Reports** – Using exception reports and surveillance reports to support firms' efforts to meet their best execution obligations.
- **PFOF Order Routing Impact Review** – Reviewing how PFOF affects the order-routing process, including the following factors: any explicit or implicit contractual arrangement to send order flow to a third-party broker-dealer; terms of these agreements; whether it is on a per share basis or per order basis; and whether it is based upon the type of order, size of order, type of customer or the market class of the security.
- **Risk-Based "Regular and Rigorous Reviews"** – Conducting "regular and rigorous" reviews, at a minimum, on a quarterly basis, but depending on the firm's business model, conducting reviews more frequently than quarterly (such as monthly).
- **Continuous Updates** – Updating WSPs and best execution analysis to address account, market and technology changes.

Additional Resources

- *Regulatory Notice* 15-46 (Guidance on Best Execution Obligations in Equity, Options and Fixed Income Markets)
- *Notice to Members* 01-22 (NASD Regulation Reiterates Member Firm Best Execution Obligations And Provides Guidance to Members Concerning Compliance)
- Report Center, Equity Report Cards – FINRA's Best Execution Outside-of-the-Inside Report Card

Large Trader Reporting

Regulatory Obligations and Related Considerations

Regulatory Obligations

Exchange Act Rule 13h-1 (Large Trader Rule) requires "large traders" to identify themselves as such to the SEC, disclose to other firms their large trader status and, in certain situations, comply with certain filing, recordkeeping and reporting requirements. These requirements help the SEC identify large traders and obtain trading information about their activity in the U.S. securities markets. In addition, broker-dealers will be required to obtain and report large trader information to the CAT for accounts with CAT Reportable Events.

Related Considerations

- Has your firm created new WSPs or updated your WSPs to address the Large Trader Rule?
- Does the firm report its relevant proprietary trading activity with the designated Large Trader ID (LTID)?
- If not, how does your firm conduct daily calculations of its own trading activity to monitor its Large Trader status?
- Has your firm updated your new customer account process to address Large Trader Rule requirements?
- Does your firm perform daily calculations of customer accounts to determine if there were any new accounts that breached the daily or monthly thresholds?
- How does your firm notify customers of their regulatory obligations if the customer has been deemed to be an "Unidentified Large Trader"?
- How does your firm work with your clearing firm to comply with the Large Trader Rule?
- How is your firm preparing to comply with CAT reporting requirements relating to LTIDs?

Exam Findings and Effective Practices

Exam Findings

- **No WSPs** – Failing to update or create new WSPs to address the Large Trader Rule, including requirements for timely filing of Form 13H and identifying, monitoring, recordkeeping and filing for large traders and Unidentified Large Traders.
- **No Monitoring for Unidentified Large Traders** – Not monitoring customer activity to identify and detect Unidentified Large Traders and notifying such traders of their obligations.
- **Failure to Report LTID** – Not reporting the LTID on Electronic Blue Sheet (EBS) submissions for applicable orders.

Effective Practices

- **WSPs** – Creating new or updated WSPs to address the Large Trader Rule, including developing WSPs to comply with the Large Trader Rule's recordkeeping requirements for its customer and proprietary trading businesses and Form 13H filing requirements for its proprietary business.
- **Form 13H Review** – Reviewing the accuracy of, and confirming any updates for, the firms' Form 13H.
- **Large Trader Check** – Adding a large trader check to firms' EBS policies and procedures to confirm that the LTID was populated and formatted correctly.
- **New Customer Account Process** – Requiring new institutional accounts to provide their LTID as part of the account opening process and, unless customers directed otherwise, requiring their LTIDs be applied to all of their new accounts.
- **Daily Large Trader and Customer Account Monitoring** – Completing daily large trader monitoring calculations to monitor the firms' large trader status; performing daily large trader monitoring calculations for their customer accounts to determine if there were any new accounts that breached the daily or monthly thresholds; and engaging their clearing firm to confirm that the clearing firm provided accurate customer LTID numbers and these numbers remained up to date.
- **Unidentified Large Traders** – Unless customers justified their exemption from the Large Trader Rule:
  - creating Unidentified Large Trader ID for those customers;
  - notifying them of potential registration obligations; and
  - advising them to request their LTID.

Additional Resources

- U.S. Securities and Exchange Commission, Office of Compliance, Inspections and Examinations, Observations from Examinations of Broker-Dealers and Investment Advisers: Large Trader Obligations (Dec. 16, 2020)
- U.S. Securities and Exchange Commission, Division of Trading and Markets, Responses to Frequently Asked Questions Concerning Large Trader Reporting (Feb. 22, 2016)
- *Regulatory Notice 18-04* (FINRA and ISG Announce Extension of Effective Date for Certain Electronic Blue Sheet Data Elements and Updates to Certain Requestor and Exchange Codes)
- FINRA's Frequently Asked Questions about Electronic Blue Sheets (EBS)

Market Access

Regulatory Obligations and Related Considerations

Regulatory Obligations

Exchange Act Rule 15c3-5 (Market Access Rule) requires broker-dealers with market access or that provide market access to their customers to "appropriately control the risks associated with market access so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system."

Related Considerations

- If your firm has market access, or provides it, does it have reasonably designed risk-management controls and WSPs to manage the financial, regulatory or other risks associated with this business activity?
- If your firm is highly automated, how does it manage and deploy technology changes for systems associated with market access, and what controls does it use, such as kill switches, to monitor and respond to aberrant behavior by trading algorithms or other impactful marketwide events?
- How does your firm adjust credit limit thresholds for customers, including institutional customers (whether temporary or permanent)?
- Does your firm use any automated controls to timely revert *ad hoc* credit limit adjustments?
- If your firm uses third-party vendor tools to comply with its Market Access Rule obligations, does it review during vendor due diligence whether the vendor can meet the obligations of the rule, and how does your firm maintain direct and exclusive control of applicable thresholds?
- What type of training does your firm provide to individual traders regarding the steps and requirements for requesting *ad hoc* credit limit adjustments?
- Does your firm test your firm's market access controls, including fixed income controls, and how do you use that test for your firm's annual CEO certification attesting to your firm's controls?

Exam Findings and Effective Practices

Exam Findings

- **Insufficient Controls** – No pre-trade order limits, pre-set capital thresholds and duplicative and erroneous order controls for accessing ATSs, especially for fixed income transactions; unsubstantiated capital and credit pre-trade financial controls; no policies and procedures to govern intra-day changes to firms' credit and capital thresholds, including requiring or obtaining approval prior to adjusting credit or capital thresholds, documenting justifications for any adjustments, and ensuring thresholds for temporary adjustments revert back to their pre-adjusted values.
- **Inadequate Financial Risk Management Controls** – For firms with market access, or those that provide it, inappropriate capital thresholds for trading desks, aggregate daily limits, or credit limits for institutional customers and counterparties.
- **Reliance on Vendors** – Relying on third-party vendors' tools, including those of an ATS, to effect their financial controls, without understanding how vendors' controls worked, and not maintaining direct and exclusive control over controls; and allowing the ATS to set capital thresholds for firms' fixed income orders instead of establishing their own thresholds (some firms were not sure what their thresholds were, and had no means to monitor their usage during the trading day).

Effective Practices

- **Pre-Trade Fixed Income Financial Controls** – Implementing systemic pre-trade "hard" blocks to prevent fixed income orders from reaching an ATS that would cause the breach of a threshold.
- **Intra-day (Ad Hoc) Adjustments** – Implementing processes for requesting, approving, reviewing and documenting ad hoc credit threshold increases, and returning the limits to their original values as needed.
- **Tailored Erroneous or Duplicative Order Controls** – Tailoring firms' erroneous or duplicative order controls to particular products, situations or order types, and preventing the routing of a market order based on impact (Average Daily Volume Control) that are set at reasonably high levels (particularly in thinly traded securities); and calibrating to reflect, among other things, the characteristics of the relevant securities, the business of the firm, and market conditions.
- **Post-Trade Controls and Surveillance** – When providing direct market access via multiple systems, including sponsored access arrangements, employing reasonable controls to confirm that those systems' records were aggregated and integrated in a timely manner and conducting holistic post-trade and supervisory reviews for, among other things, potential manipulative trading patterns.
- **Testing of Financial Controls** – Periodically testing their market access controls, which forms the basis for an annual CEO certification attesting to firms' controls.

Additional Resources

- *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)
- *Regulatory Notice* 15-09 (Guidance on Effective Supervision and Control Practices for Firms Engaging in Algorithmic Trading Strategies)
- Algorithmic Trading Topic Page
- Market Access Topic Page

Vendor Display Rule

Regulatory Obligations and Related Considerations

Regulatory Obligations

Rule 603 of Regulation NMS (Vendor Display Rule) generally requires broker-dealers to provide a consolidated display of market data for NMS stocks for which they provide quotation information to customers. Rule 600(b)(14) of Regulation NMS provides that the consolidated display includes "(i) the prices, sizes, and market identifications of the national best bid and national best offer for a security; and (ii) [c]onsolidated last sale information for a security," while Rule 600(b)(15) of Regulation NMS provides that "consolidated last sale information" includes "the price, volume, and market identification of the most recent transaction report for a security that is disseminated pursuant to an effective national market system plan."

Related Considerations

- Which firm systems or platforms provide quotation information to customers?
- How does your firm monitor whether the current quotation information is distributed to customers?
- Does your firm make the quotation information available to customers when they are placing their orders?
- Does your firm review the quotation information received from the Securities Information Processor (SIP) or vendors to determine whether that information is in compliance with all the requirements of SEC Rule 603?

Exam Findings and Effective Practices

Exam Findings

- **Failure to Provide Consolidated Display**
  - **Missing Consolidated Display** – Failing to provide the entire consolidated display:
    - in all contexts and relevant stages in which a customer may make a trading or routing decision, (such as at point of order entry and order modification); and
    - across all platforms where customers may make a trading or routing decision (such as displaying all elements of the consolidated display on firms' web-based but not mobile device platforms).
  - **Missing Elements** – Providing the consolidated display, but not including certain elements, such as:
    - national best bid and offer (NBBO) (while providing only the last sale information);
    - last sale information (while providing only the NBBO);
    - market identification for NBBO or last sale;
    - size associated with NBBO or last sale; and
    - real-time NBBO and last sale information (*e.g.,* 15-minute delayed data).
- **Insufficient WSPs** – Failing to maintain WSPs to address the Vendor Display Rule, periodic testing and validation that they were providing the consolidated display, and review for timely delivery of the consolidated display to customers (including evaluating and addressing any potential system latencies).

Effective Practices

- **Confirming Market Data Feeds** – Confirming that firms received all market data feeds (including all exchanges) necessary to provide consolidated quote and last sale information to customers (including all prices, sizes and market identification data).
- **Customer Platform Reviews** – Performing a comprehensive review to confirm that firms provided the consolidated display to customers across all platforms where customers may make a trading or order-routing decision (including mobile platforms).
- **Latency Monitoring** – Monitoring for any delays or latency of the consolidated display, especially for mobile platforms, and then taking corrective action to confirm that the Consolidated Display information was current.
- **SIP Validation** – Performing periodic validation of quotation and last sale information against SIP data by creating screenshots of firms' quotation and last sale information for each customer platform and comparing it to SIP quotation and last sale information data.
- **Testing and Validation** – Testing and validating the consolidated display prior to and after upgrades or enhancements to customer platforms.

Additional Resources

- *Regulatory Notice* 15-52 (SEC Staff Provides Insight Into Firms' Obligations When Providing Stock Quote Information to Customers)
- Regulation NMS Topic Page

Financial Management

Net Capital

Regulatory Obligations and Related Considerations

Regulatory Obligations

Exchange Act Rule 15c3-1 (Net Capital Rule) requires that firms must at all times have and maintain net capital at specific levels to protect customers and creditors from monetary losses that can occur when firms fail. Exchange Act Rule 17a-11 requires firms to notify FINRA in the event their net capital falls below the "minimum amount required" by the Net Capital Rule.

Related Considerations

- How does your firm review its net capital treatment of assets to confirm that they are correctly classified for net capital purposes?
- How does your firm confirm that it has correctly identified and aged all failed-to-deliver contracts, properly calculated the applicable net capital charges and correctly applied the deductions to its net capital calculation?
- For firms with expense sharing agreements, what kind of allocation methodology does your firm use and what kind of documentation does your firm maintain to substantiate its methodology for allocating specific broker-dealer costs to the firm or an affiliate?

Exam Findings and Effective Practices

Exam Findings

- **Inaccurate Classification of Receivables, Liabilities and Revenue** – Incorrectly classifying receivables, liabilities and revenues, which resulted in inaccurate reporting of firms' financial positions and, in some instances, a capital deficiency; incorrectly classifying non-allowable assets, such as large investments in certificates of deposit (CDs) because firms did not have a process to assess the net capital treatment of CDs pursuant to Exchange Act Rule 15c3-1(c)(2)(vi)(E); and not reviewing account agreements for CDs to determine whether they contained stipulations restricting withdrawals prior to maturity, including restricting their withdrawal or giving the bank discretion to permit or prohibit their withdrawal.
- **Failed to Deliver and Failed to Receive Contracts (Fails)** – Not having a process to correctly identify, track and age intra-month and end of the month Fails for firms' operating an Exchange Act Rule 15a-6 chaperoning business, including:
  - **Inaccurate Net Capital Charge** – Failing to compute and apply the correct applicable net capital charge for aged Fails;
  - **No Information from Clearing Firm** – Failing to request or confirm receipt of timely information relating to Fails from their clearing firms;
  - **Gaps in Policies and Procedures** – Failing to address monitoring, reporting and aging of Fails in firms' policies and procedures;
  - **Incorrect Balance Sheets and FOCUS Reports** – Failing to record Fails on firms' balance sheet, and, as a result, filing incorrect FOCUS reports; and
  - **No Blotters** – Failing to maintain blotters for Fails.

- **Incorrect Capital Charges for Underwriting Commitments** – Not maintaining an adequate process to assess moment-to-moment and open contractual commitment capital charges on underwriting commitments, and not understanding their role as it pertained to the underwriting (*i.e.,* best efforts or firm commitment).
- **Inaccurate Recording of Revenue and Expenses** – Using cash accounting to record revenue and expenses as of the date the money changes hands, rather than accrual accounting (where firms would record revenue and expenses as of the date that revenue is earned or expenses are incurred); and making ledger entries as infrequently as once per month, as a result of which firms did not have adequate context to determine the proper accrual-based transaction date.
- **Insufficient Documentation Regarding Expense-Sharing Agreements** – Not delineating a method of allocation for payment; not allocating (fixed or variable) expenses proportionate to the benefit to the broker-dealer; or not maintaining sufficient documentation to substantiate firms' methodologies for allocating specific broker-dealer costs—such as technology fees, marketing charges, retirement account administrative fees and employees' compensation—to broker-dealers or affiliates.

Effective Practices

- **Net Capital Assessment** – Performing an assessment of their net capital treatment of assets, including CDs, to confirm that they were correctly classified for net capital purposes.
- **Agreement Review** – Obtaining from, and verifying with, banks the withdrawal terms of any assets, with particular focus on CD products, and reviewing all of the agreement terms, focusing on whether withdrawal restrictions may affect an asset's classification and its net capital charge for the terms of all assets, including CDs, and reviewing all of the agreement terms, focusing on whether withdrawal restrictions may affect an asset's classification and its net capital charge.
- **Training and Guidance** – Developing guidance and training for Financial and Operational Principal and other relevant staff on Net Capital Rule requirements for Fails, including how to report Fails on their balance sheets, track the age of Fails and, if necessary, calculate any net capital deficit resulting from aged Fails.
- **Aging Review** – Performing reviews to confirm that they correctly aged Fail contract charges and correctly applied a net capital deduction, when applicable, to their net capital calculation.
- **Collaboration with Clearing Firms** – Clarifying WSPs to address clearing firms' responsibilities regarding net capital requirements, including for Fails, and introducing firms engaging their clearing firms to confirm that:
  - introducing firms were receiving a record of all Fails on a daily basis (or at least monthly);
  - clearing firms' reports included all of the required information; and
  - introducing firms were correctly interpreting the clearing firms' reports (especially distinctions between trade date and settlement date and those dates' implications for aging calculations for Fails).

Additional Resources

- Interpretations of Financial and Operational Rules
- *Regulatory Notice* 15-33 (Guidance on Liquidity Risk Management Practices)
- *Regulatory Notice* 10-57 (Funding and Liquidity Risk Management Practices)
- *Notice to Members* 03-63 (SEC Issues Guidance on the Recording of Expenses and Liabilities by Broker/Dealers)
- Funding and Liquidity Topic Page

Liquidity Management

Regulatory Obligations and Related Considerations

Regulatory Obligations

Effective liquidity controls are critical elements in a broker-dealer's risk management framework. Exchange Act Rule 17a-3(a)(23) requires firms that meet the thresholds specified under the rule to make and keep current records documenting the credit, market, and liquidity risk management controls established and maintained by the firm to assist it in analyzing and managing the risks associated with its business. 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.

Related Considerations

- What departments at your firm are responsible for liquidity management?
- How often does your firm review and adjust its liquidity management plan and the stress test frameworks?
- Do your firm's liquidity management practices include steps to address specific stress conditions and identify firm staff responsible for addressing those conditions? Does your firm have a process for accessing liquidity during a stress event and determining how the funding would be used?
- Does your firm's contingency funding plan take into consideration the quality of collateral, term mismatches and potential counterparty losses of your firm's financing desks (in particular, in repo and stock loan transactions)?
- What kind of stress tests (*e.g.,* market or idiosyncratic) does your firm conduct? Does your firm conduct stress tests in a manner and frequency that is appropriate for your firm's business model, for example tests limited to a single time horizon, or over multiple time horizons? Does your firm incorporate the results of those stress tests into your firm's business model?

Exam Observations and Effective Practices

Exam Observations

- **Not Extending the Stress Test Period** – Failing to expand stress tests from a single time horizon to multiple time horizons (such as 10 days to 30 days or longer).
- **Not Modifying Business Models** – Failing to incorporate the results of firms' stress tests into their business model.
- **No Liquidity Contingency Plans** – Failing to develop contingency plans for operating in a stressed environment with specific steps to address certain stress conditions, including identifying the firm staff responsible for enacting the plan, the process for accessing liquidity during a stress event and setting standards to determine how liquidity funding would be used.

Effective Practices

- **Liquidity Risk Management Updates** – Updating liquidity risk management practices to take into account a firm's current business activities, including:
  - establishing governance around liquidity management, determining who is responsible for monitoring the firm's liquidity position, how often they monitor that position, and how frequently they meet as a group; and

- creating a liquidity management plan that considers:
  - quality of funding sources;
  - potential mismatches in duration between liquidity sources and uses;
  - potential losses of counterparties;
  - how the firm obtains funding in a business-as-usual (BAU) condition, and stressed conditions;
  - assumptions based on idiosyncratic and market-wide conditions; and
  - early warning indicators, and escalation procedures, if risk limits are breached.

- **Stress Tests** – Conducting stress tests in a manner and frequency that considered the firm's business model, including:
  - assumptions specific to the firm's business, and based on historical data;
  - the firm's sources and uses of liquidity, and if sources could realistically fund its uses in a stressed environment;
  - the potential impact of off-balance sheet items on liquidity;
  - frequency of conducting stress tests, in accordance with the risk and complexity of the firm's business; and
  - periodic review of stress test results by appropriate governance groups.

Additional Resources

- *Regulatory Notice* 15-33 (Guidance on Liquidity Risk Management Practices)
- *Regulatory Notice* 10-57 (Funding and Liquidity Risk Management Practices)
- Funding and Liquidity Topic Page

Credit Risk Management

Regulatory Obligations and Related Considerations

Regulatory Obligations

Under the financial responsibility rules, and related supervisory obligations, firms need to properly capture, measure, aggregate, manage and report credit risk, including risk exposures that may not be readily apparent. Such responsibility can be incurred under clearing arrangements, prime brokerage arrangements (especially fixed income prime brokerage), "give up" arrangements, sponsored access arrangements (discussed above in the Market Access section) or principal letters. Further, firms should maintain a robust internal control framework where they manage credit risk and they identify and address all relevant risks covering the extension of credit to their customers and counterparties. Weaknesses within the firm's risk management and control processes could result in a firm incorrectly capturing its exposure to credit risk.

Related Considerations

- Does your firm maintain a robust internal control framework to capture, measure, aggregate, manage, supervise and report credit risk?

- Does your firm review whether it is accurately capturing its credit risk exposure, maintain approval and documented processes for increases or other changes to assigned credit limits and monitor exposure to affiliated counterparties?
- Does your firm have a process to confirm it is managing the quality of collateral and monitoring for exposures that would have an impact on capital?

Exam Observations and Effective Practices

Exam Observations

- **No Credit Risk Management Reviews** – Not evaluating firms' risk management and control processes to confirm whether they were accurately capturing their exposure to credit risk.
- **No Credit Limit Assignments** – Not maintaining approval and documentation processes for assignment, increases or other changes to credit limits.
- **No Monitoring Exposure** – Not monitoring exposure to firms' affiliated counterparties.

Effective Practices

- **Credit Risk Framework** – Developing comprehensive internal control frameworks to capture, measure, aggregate, manage and report credit risk, including:
  - establishing house margin requirements;
  - identifying and assessing credit exposures in real-time environments;
  - issuing margin calls and margin extensions (and resolving unmet margin calls);
  - establishing the frequency and manner of stress testing for collateral held for margin loans and secured financing transactions; and
  - having a governance process for approving new, material margin loans.
- **Credit Risk Limit Changes** – Maintaining approval and documentation processes for increases or other changes to assigned credit limits, including:
  - having processes for monitoring limits established at inception, and on an ongoing basis, for customers and counterparties;
  - reviewing how customers and counterparties adhere to these credit limits, and what happens if these credit limits are breached; and
  - maintaining a governance structure around credit limit approvals.
- **Counterparty Exposure** – Monitored exposure to their affiliated counterparties, considering their:
  - creditworthiness;
  - liquidity and net worth;
  - track record of past performance (*e.g.,* traded products, regulatory history, past arbitration and litigation); and
  - internal risk controls.

Additional Resources

- Funding and Liquidity Topic Page

Segregation of Assets and Customer Protection

Regulatory Obligations and Related Considerations

Regulatory Obligations

Exchange Act Rule 15c3-3 (Customer Protection Rule) imposes certain requirements on firms that are designed to protect customer funds and securities. Firms are obligated to maintain custody of customer securities and safeguard customer cash by segregating these assets from the firm's proprietary business activities, and promptly deliver to their owner upon request. Firms can satisfy this requirement by either keeping customer funds and securities in their physical possession, or in a good control location that allows the firm to direct their movement (*e.g.,* a clearing corporation).

Related Considerations

- What is your firm's process to prevent, identify, research and escalate new or increased deficits which are in violation of the Customer Protection Rule?
- What controls does your firm have in place to identify and monitor its possession or control deficits, including the creation, cause and resolution?
- If your firm claims an exemption from the Customer Protection Rule and it is required to forward customer checks promptly to your firm's clearing firm, how does your firm implement consistent processes for check forwarding and maintain accurate blotters to demonstrate that checks were forwarded in a timely manner?
- How does your firm train staff on Customer Protection Rule requirements?
- What are your firm's processes to confirm that your firm correctly completes its reserve formula calculation and maintains the amounts that must be deposited into the special reserve bank account(s)?
- If your firm is engaging in digital asset transactions, what controls and procedures has it established to support facilitation of such transactions, including initial issuance or secondary market trading of digital assets? Has the firm analyzed these controls and procedures to address potential concerns that they may be viewed as a custodian (*i.e.,* holding or controlling customer property)?

Exam Findings and Effective Practices

Exam Findings

- **Inconsistent Check-Forwarding Processes** – Not implementing consistent processes for check forwarding to comply with an exemption from the Customer Protection Rule.
- **Inaccurate Reserve Formula Calculations** – Failing to correctly complete reserve formula calculations due to errors in coding because of limited training and staff turnover, challenges with spreadsheet controls, limited coordination between various internal departments and gaps in reconciliation calculations.
- **Omitted or Inaccurate Blotter Information** – Maintaining blotters with insufficient information to demonstrate that checks were forwarded in a timely manner and inaccurate information about the status of checks.

Effective Practices

- **Legal and Compliance Engagement** – Collaborating with legal and compliance departments to confirm that all agreements supporting control locations are finalized and executed before the accounts are established and coded as good control accounts on firms' books and records.

- **Addressing Conflicts of Interest** – Confirming which staff have system access to establish a new good control location and that they are independent from the business areas to avoid potential conflicts of interest; and conducting ongoing review to address emerging conflicts of interest.
- **Reviews and Exception Reports for Good Control Locations** – Conducting periodic review of and implementing exception reports for existing control locations for potential miscoding, out-of-date paperwork or inactivity.
- **Check-Forwarding Procedures** – Creating and implementing policies to address receipt of customer checks, checks written to the firm, and checks written to a third party.
- **Check Forwarding Blotter Review** – Creating and reviewing firms' check received and forwarded blotters to confirm that they are up to date, and including the information required to demonstrate compliance with the Customer Protection Rule exemption.

Additional Resources

- Customer Protection – Reserves and Custody of Securities (SEA Rule 15c3-3)
- U.S. Securities and Exchange Commission, Custody of Digital Assets Securities by Special Purpose Broker-Dealers, Exchange Act Release No. 90,788 (Dec. 23, 2020)
- U.S. Securities and Exchange Commission, No-Action Letter to FINRA re: ATS Role in the Settlement of Digital Asset Security Trades (Sept. 25, 2020)

Appendix—Using FINRA Reports in Your Firm's Compliance Program

Firms have shared the following ways they have used prior FINRA publications, such as Exam Findings Reports and Priorities Letters (collectively, Reports), to enhance their compliance programs. We encourage firms to consider these practices, if relevant to their business model, and continue to provide feedback on how they use FINRA publications.

- **Assessment of Applicability** – Performed a comprehensive review of the findings, observations and effective practices, and identified those that are relevant to their businesses.
- **Risk Assessment** – Incorporated the topics highlighted in our Reports into their overall risk assessment process and paid special attention to those topics as they performed their compliance program review.
- **Gap Analysis** – Conducted a gap analysis to evaluate how their compliance programs and WSPs address the questions noted in Priorities Letters and the effective practices in Exam Findings Reports, and determined whether their compliance programs have any gaps that could lead to the types of findings noted in Exam Findings Reports.
- **Project Team** – Created interdisciplinary project teams and workstreams (with staff from operations, compliance, supervision, risk, business and legal departments, among other departments) to:
  - assign compliance stakeholders and project owners;
  - summarize current policies and control structures for each topic;
  - engage the legal department for additional guidance regarding regulatory obligations;
  - develop plans to address gaps; and
  - implement effective practices that were not already part of their compliance program.
- **Circulation to Compliance Groups** – Shared copies of the publications or summaries of relevant sections with their compliance departments.
- **Presentation to Business Leaders** – Presented to business leadership about their action plans to address questions, findings, observations and effective practices from our Reports.
- **Guidance** – Used Reports to prepare newsletters, internal knowledge-sharing sites or other notices for their staff.
- **Training** – Added questions, findings, observations and effective practices from Reports, as well as additional guidance from firms' policies and procedures, to their Firm Element and other firm training.

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Background and Discussion

Pursuant to Securities Exchange Act of 1934 (SEA) Rule 15b2-2, new FINRA member firms undergo an initial examination within either six or twelve months of the effective date of their registration with the Securities and Exchange Commission (SEC), depending on the commencement date of their business. The purpose of this examination is to assess whether the firm is conducting its business operations in compliance with federal securities rules and regulations that are relevant to their business.

FINRA recognizes that new member firms devote considerable resources to compliance while trying to launch their business operations and publishes this document to help such firms avoid some of the most common findings FINRA has identified in its initial firm examinations in recent years. The document includes:

- a short synopsis of the relevant rules;
- a summary of common findings,
- effective practices FINRA has observed firms implement; and
- a list of relevant FINRA resources.

While this document was compiled to highlight some more common findings, please note it is not intended to address all areas that a new member firm should consider when developing a robust supervisory program. It is our sincere hope that you will see this outreach as the beginning of a positive relationship with FINRA where our goal is to protect investors and the integrity of the markets while supporting your member firm in its business.

1. **Outside Business Activities (OBA) of Registered Persons**

FINRA Rule 3270 (Outside Business Activities of Registered Persons) requires registered persons to notify member firm(s) in writing prior to engaging in any covered business activity outside the scope of the relationship with his or her member firm. The rule's Supplementary Material outlines obligations of the member receiving the notice, including factors to consider when evaluating whether to approve a proposed OBA and documentation requirements. In addition, following firm approval of the OBA and pursuant to FINRA By-Laws Article V, Sec. 2(c), firms are required to update Section 13 (Other Business) of Form U4 within 30 days.

FINRA's initial examinations of new member firms frequently identified the following findings related to OBAs:

a. *Accepting OBA Notice & Amending Form U4:* Firms often overlook timely filing a Form U4 amendment in response to notice of a new OBA from a registered person and, where an amendment is made, firms often do not include the detail described in the Form U4 instructions. Firms frequently accept registered representatives' oral notifications of OBAs – which itself is a rule violation – but which also heightens the risk that the firm may not correctly understand the scope of the OBA. Effective practices include requiring registered representatives to provide periodic attestations of active OBAs, the firm to compare the attestations to the Form U4, and requiring all communications related to OBAs beyond the obligatory written notification to also be in writing.

b. *Supervisory Review of OBAs:* Firms often do not fulfill or document supervisory review of OBAs following receipt of notice from a registered person. In addition, firms do not have (or do not implement) adequate Written Supervisory Procedures (WSPs) outlining supervisory processes or firm principals do not evaluate some or all of the considerations outlined in Supplementary Material .01 of Rule 3270. Firms are also occasionally unaware of their authority to set conditions or apply limitations (including denial) to a registered person's participation in an OBA. Effective practices FINRA observed firms implement include creating and using forms that contain the review and approval factors noted in FINRA Rule 3270, Supplementary Material .01; information required to complete a Form U4 Amendment; and any other details firm principals require to fulfill their supervisory obligations, such as whether the OBA will have common customers with the firm and whether the OBA is expected to interact with the firm in a business capacity.

Firms should be aware that FINRA strives to maintain a current and efficient ruleset through its retrospective rule review process. FINRA Rule 3270 (and FINRA Rule 3280 (Private Securities Transactions of an Associated Person), discussed below) are two of the rules currently under review through this process, so it is important that firms watch for possible future rule amendments that could change obligations under these rules.

OBA Resources

- FINRA Rule 3270 and Supplementary Material
- FINRA 2017 Examination Findings Report: Outside Business Activities and Private Securities Transactions
- FINRA Rule 3110
- *Regulatory Notice 18-08* (FINRA Requests Comment on Proposed New Rule Governing Outside Business Activities and Private Securities Transactions)

2. Private Securities Transactions of Associated Persons (PSTs)

FINRA Rule 3280 requires associated persons to provide firms with written notice of their intention to engage in a PST. In addition, the rule requires the firm to provide a written approval or denial of the request and, if approved, to record the transaction on its books and records and to supervise the transaction as if it were executed on behalf of the member.

FINRA's initial examinations of new member firms frequently identified the following findings related to PSTs:

a. *Accepting and Reviewing PST Notice*: Some firms did not establish WSPs regarding the review and approval of associated persons' PSTs, while others had adequate procedures but did not follow such procedures. Effective practices FINRA observed include paying special attention to any OBAs that involve roles with investment advisors or fund companies in order to identify potential PSTs. Activities that involve raising capital or directing securities transactions are likely to fit the definition of a PST under FINRA Rule 3820.

b. *Supervision and Recordkeeping:* Some firms did not adequately supervise approved PSTs or record these transactions on the books and records of the firm as required under the Rule. Firms have given blanket approval to PSTs rather than the transaction-by-transaction approval required under FINRA Rule 3280.

PST Resources

- FINRA 2017 Examination Findings Report: Outside Business Activities and Private Securities Transactions
- *Regulatory Notice 18-08* (FINRA Requests Comment on Proposed New Rule Governing Outside Business Activities and Private Securities Transactions)

3. Communications with the Public

FINRA Rule 2210 (Communications with the Public), the primary rule governing firms' communications, imposes specific requirements for the internal approval and supervision of communications, recordkeeping standards, filing requirements and extensive content standards, including that communications are fair, balanced and not misleading. Notably, new member firms must file with FINRA's Advertising Regulation Department (AdReg) all retail communications (available to more than 25 retail investors over a 30-day period) and advertisements 10 days prior to first use for a one-year period dating from the date on which the firm's registration with FINRA became effective. In addition, member firms may also voluntarily file other communications directly with AdReg for review.

AdReg reviews member firms' communications with the public to ensure that they are fair, balanced, and not misleading. AdReg applies FINRA, SEC, Municipal Securities Rule Making Board (MSRB), and Securities Investor Protection Corporation (SIPC) rules pertaining to communications, including email, electronic messages, websites, advertisements, hard copy marketing materials, video content and seminars. AdReg reviews assist Member Supervision staff in conjunction with the Membership Application Process (MAP) process, examinations and investigations.

FINRA's initial examinations of new member firms frequently identified the following findings related to their communications with the public:

a. *Failure to File:* Some firms did not file required communications with AdReg prior to first use. This includes, for example, retail communications published or used in any public media, including generally accessible websites, search advertisements, brochures, commercials and print communications.

b. *Problematic content:* Problematic content often involved omissions of material facts about investments such as risks or costs or the inclusion of misleading, exaggerated or unwarranted statements or claims. Other content concerns included failures to clearly distinguish between the services of the member and those of its affiliates or an outside business of a registered representative.

FINRA has observed that firms that failed to submit required filings with AdReg were more likely to have used communications that raised content concerns.

Communications with the Public Resources

- Requirements for New and Pending Member Firms
- What and When to File with Advertising Regulation
- Guidance related to Advertising Regulation
- FINRA Rule 2210

4. **Electronic Communications**

FINRA Rule 3110(b)(4) (Review of Correspondence and Internal Communications) and related Supplementary Material .06, .07. and .09 of Rule 3110 covers a firm's obligations to conduct a Principal review of internal and external correspondence, including requirements around recordkeeping. SEA Rule 17a-4(f)(2) requires firms to notify FINRA when selecting or changing a service provider for the archiving of electronic correspondence.

FINRA's initial examinations of new member firms frequently identified the following findings related to electronic communications:

a. *Lack of supervisory review:* Firms failed to conduct a supervisory review of correspondence pursuant to their WSPs, document the supervisory review of correspondence, archive or review alternative methods of correspondence used for business purposes and allowed individuals to review their own correspondence. Effective practices include the use of tracking tools provided by many Electronic Storage Media ("ESM") vendors that allow for correspondence reviews to be documented within their systems, conducting a search for third-party email tags (*e.g.*, Gmail, Yahoo) within email chains to see if registered representatives are conducting business communications outside of approved channels, and using customizable lexicon searches to target reviews to the firm's business activities.

b. *Failure to notify FINRA:* Some firms did not comply with SEA Rule 17a-4(f)(2) which requires firms to file a notification with FINRA when they retain a third-party ESM service provider. These notifications are required for the initial selection of the service provider and any subsequent changes of vendor.

Electronic Communications Resources

- Guidance on Books and Records and Electronic Communications
- FINRA 2019 Examination Findings Report – Digital Communication
- *Regulatory Notice 17-18* (Guidance on Social Networking Websites and Business Communications)

5. Individuals with Access to Financial Books & Records

SEA Rule 17f-2 requires all employees of a broker-dealer to be fingerprinted. The rule contains various exceptions which would release the firm from this requirement. Some exceptions are based on job-specific duties while others are based on the business lines of the firm. The rule specifies that, among other factors, an exempt individual must not regularly have access to the keeping,

handling, and processing of securities, monies, or the original books and records related to securities or monies.

FINRA's initial examinations of new member firms frequently found that while firms generally and appropriately fingerprinted individuals registered as Financial and Operations Principals, firms failed to fingerprint individuals – such as bookkeepers or other associated persons – whose job duties involve entering information into the firm's General Ledger or performing ministerial tasks involving the firm's financial records.

Fingerprint Requirement Resources

- Fingerprinting of securities industry personnel
- Fingerprinting FAQs

6. Operations Professional (Series 99)

FINRA Rule 1220(b)(3) (Operations Professional) requires registration as an Operations Professional for specified individuals whose job duties interact with a list of "Covered Functions." The list of Covered Functions is extensive and includes operational duties such as client on-boarding, bank account management, the preparation of regulatory filings and the preparation of trade confirmations and account statements. Individuals who can be classified as senior management over a Covered Function, a designee of senior management who can approve or authorize work over a Covered Function or an individual with the authority or discretion to commit the firm's capital in furtherance of a Covered Function must be registered as an Operations Professional and hold the Series 99 License. The Rule provides a mechanism for those with specified existing registrations to register as an Operations Professional without passing an additional qualification examination.

This area was highlighted in FINRA's 2018 Exam Findings Report. Common exceptions noted in that report included unregistered individuals approving General Ledger entries, unregistered supervisors, and unregistered individuals approving business requirements of trading systems.

FINRA's initial examinations of new member firms frequently identified that middle and back-office staff that conduct who covered functions in FINRA Rule 1220(b)(3) have had not obtained the requisite Operations Professional registration, either through the Series 99 examination or through an examination waiver. An effective practice to ensure compliance with FINRA Rule 1220(b)(3) is to distribute a questionnaire to associated persons asking whether they conduct any of the enumerated covered functions. This practice facilitates the identification of associated persons requiring the license based on actual conduct rather than by department or job title.

Operations Professional Resources

- *Regulatory Notice 11-33* (SEC Approves Operations Professional Registration Category and Consolidated FINRA Continuing Education Rule)
- Series 99 Examination Information
- FINRA 2018 Exam Findings Report – Operations Professional Registration

7. Expense Sharing Agreements

SEA Rule 17a-3 requires a broker-dealer to make a record reflecting each expense incurred relating to its business and any corresponding liability, regardless of whether the liability is joint or several with any person and regardless of whether a third party has agreed to assume the expense or liability. FINRA's guidance on the establishment and implementation of an Expense-Sharing Agreement ("ESA") is contained in *Notice to Members* *03-63*. An ESA is defined in the Notice as any agreement in which another party bears or pays for all or a portion of the costs incurred by a broker-dealer. Through an ESA, a firm may record a shared expense based on an allocation made on a reasonable basis. This area of concern was also identified previously in FINRA's 2018 Exam Findings Report.

FINRA's initial examinations of new member firms frequently identified the following findings related to ESAs:

a. *Absence of Required ESA:* Examinations have found that firms are sharing expenses with affiliates without implementing an ESA.

b. *Improperly Implemented ESAs*: some firms were not properly implementing an approved ESA. Examples of this include the third party paying for expenses that were not specified in the ESA or paying amounts different from those specified in the agreement.

c. *Lack of Adequate Resources*: Another issue in this area includes the ESA specifying an entity as responsible for broker-dealer expenses that does not have adequate resources independent of the broker-dealer to satisfy the obligations.

d. *Unreasonable Allocation Methodology:* Some firms were not following the guidance contained in *Notice to Members 03-63* requiring a reasonable allocation of expenses. One common example is the use of revenue or profitability to allocate the proportion of fixed shared expenses between entities. Such expenses include office rent, utilities, salaries of administrative staff, and insurance.

e. *Lack of Specific Identification of Services Provided:* Some firms were using ESAs that did not enumerate the products and services being provided to the broker-dealer. In those cases, the ESA would use over-broad descriptions of services such as "overhead" or "administrative".

Expense Sharing Agreement Resources

- *Notice to Members 03-63* (Expense-Sharing Agreements: SEC Issues Guidance on the Recording of Expenses and Liabilities by Broker/Dealers)
- FINRA 2018 Exam Findings Report – Accuracy of Net Capital Computations

8. Private Placements / Unregistered Offerings

FINRA Rule 3110 (Supervision) requires all firms to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations. The rule requires written procedures (and a process) to supervise the types of business in which it engages. For firms that engage in the sale of private placements, the procedures and supervisory system are expected to cover the firm's due diligence on each offering, supervision over all aspects of the offering and sales to clients , and associated regulatory filings as required under FINRA Rules 5122 and 5123, when applicable.

FINRA *Regulatory Notice 10-22* describes the circumstances under which firms have an obligation to conduct a reasonable investigation for unregistered offerings, as well as the need to document both the process and results of its due diligence investigation. FINRA Rule 5122 obligates any member firm that sells a private offering of unregistered securities issued by the member firm or a control entity (self-offering) to make the required filing prior to the initiation of the offering or first use of offering materials. Rule 5123 requires each firm that sells a security in a private placement (with certain exemptions) to file a copy of the offering document (private placement memorandum, term sheet, or other offering document) with FINRA within 15 calendar days of the date of the first sale. If the firm does not use any offering documents, then the firm must notify FINRA of this fact.
Rues 5122 and 5123 also require firms to file any materially amended versions of the documents originally filed. Each rule includes factors that would exempt a firm from making these filings.

FINRA's initial examinations of new member firms frequently identified the following findings related to their private placement or unregistered offering activity:

a. *No Reasonable Diligence*: Some new member firms did not conduct adequate reasonable diligence prior to recommending an unregistered offering to investors. For example, some firms reviewed the offering memorandum, due diligence questionnaire, or other relevant offering documentation, but did not discuss or question the offering in greater detail with the issuer or independently verify, research, or analyze material aspects of the offering. FINRA has also found that certain firms did not adequately document the process and results of their due diligence analysis.

b. *Failure to File Timely:* Some new member firms failed to timely submit the filings required by FINRA Rules 5122 and 5123. Member firms that participate in the sale of securities through a private placement are required to submit filings to FINRA through the Firm Gateway. Some firms are unaware that filing requirements apply to any member firm conducting a sale or offer of a private placement; therefore, a broker-dealer acting in the capacity of placement agent, selling agent, alternative trading system, finder or any other role that promotes or facilitates the sale or offer of private placements is subject to the filing requirements *unless* an exemption from filing is available.

Unregistered Offering/Private Placement Resources

- Frequently Asked Questions (FAQ) about Private Placements
- Firm Guidance – Private Placement Filings
- Key Topics: Private Placements

- *Regulatory Notice 10-22* (Obligation of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings)
- 2018 Examination Findings Report – Reasonable Diligence for Private Placements

FINRA's Membership Application Program (MAP)
Tuesday, October 5
11:00 a.m. – 11:30 a.m.

Attend this session to hear about FINRA's Membership Application Program (MAP). Learn how FINRA evaluates proposed business activities of potential and existing member firms, including the applicant's financial, operational, supervisory and compliance systems. This session provides an overview of the application process.

Moderator:
Leyna Goro
Associate District Director, MAP
FINRA Member Supervision

Panelists:
Patricia Dorilio
Associate District Director, MAP
FINRA Member Supervision

Kayla Martin
Examiner, MAP
FINRA Member Supervision

Robert Schmidt
Principal Analyst, Risk Monitoring – Jericho Office
FINRA Member Supervision

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FINRA's Membership Application Program (MAP) Panelist Bios:

Moderator:



Leyna Goro is Associate Director in the FINRA Membership Application Program (MAP) group. Ms. Goro oversees a team of managers and examiners reviewing applications from current and proposed FINRA members. She plays a key role in analyzing firm business activities and products, including complex and novel matters. Ms. Goro also provides insight to FINRA constituents on the membership process in areas such as compliance, various securities products, Anti-Money Laundering, risk assessments, and structural changes. Ms. Goro has served as an expert speaker on industry panels, and frequently interfaces with regulatory agencies on topics impacting the FINRA membership space. Ms. Goro was previously a MAP team supervisor, and before that, held various positions at FINRA, including examiner in the cycle and application review programs. Ms. Goro has provided significant input on several high-profile initiatives, including the NASD/NYSE merger process, FINRA's retrospective review of the MAP rules, and most recently, the implementation and rollout of FINRA Rule 1017(a)(7). She has served as a FINRA National Regulatory Expert and has completed the FINRA Excellence in Management Program at Wharton.

Panelists:



Patricia Dorilio is Associate Director in the Membership Application Program (MAP) group at FINRA, a position she has held since October 2019. Ms. Dorilio oversees a team of managers and examiners in the execution of the application review program, including expedited reviews where applicable, to determine applicants' satisfaction of standards for FINRA membership, and standards for firms' continuation of membership. This includes the review and analysis of information and documentation relating to proposed business activities and securities products, and firms' structural and ownership changes. She has also completed the FINRA Excellence in Management Program at Wharton. Prior to joining MAP in 2011 as a MAP examiner, Ms. Dorilio was employed in the private sector, and immediately prior to that, held the position of Senior Special Counsel at the New York Stock Exchange. She began her career as an Assistant Attorney General in the New York State Attorney General's Office. Ms. Dorilio earned her Juris Doctor from the Maurice A. Dean School of Law at Hofstra University, and a B.A. in Political Science from Hofstra University. She is a member of the bar of the State of New York.



Kayla Martin has been an Examiner with FINRA's Membership Application Program (MAP) Group since December 2019. Ms. Martin received her Juris Doctor degree from St. John's University School of Law in May 2019 and in August 2020, was admitted to the New York State Bar. During law school, Ms. Martin interned with FINRA's Office of Fraud Detection and Market Intelligence ("OFDMI") from January 2019 – April 2019 where she investigated cases and reviewed regulatory filings for violations of federal securities laws and FINRA regulations, including unsuitability, misappropriation of funds, unauthorized trading, churning/excessive trading, failure to maintain adequate books and records, insider trading, and fraud. Prior to interning with OFDMI, Ms. Martin served as a compliance intern with Betterment from September 2018 – November 2018 where she was responsible for reviewing and amending the firm's policies and procedures regarding books and records, disclosure requirements, and pay to play rules. Ms. Martin further organized firm records to assist with regulatory examinations and ensure compliance with SEC's and FINRA's books and records rules and coordinated with an independent AML auditor to facilitate the firm's annual AML audit by responding to inquiries requesting documentation, including the KYC/CIP programs, Office of Foreign Assets Control ("OFAC") and FinCEN checks, suspicious activity reports ("SARs"), and AML training. From January 2018 – May 2018, Ms. Martin was a legal intern for St. John's University School of Law's Securities Arbitration Clinic where she represented retail investors in securities arbitration claims involving violations of FINRA regulations. Prior to law school, Ms. Martin received a Bachelor of Business Administration degree for Legal

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Studies in Business, with a minor in Finance, from Hofstra University in December 2015 and worked as a paralegal for an insurance defense firm, Carman, Callahan, & Ingham, LLP.



Robert Schmidt is Principal Risk Monitoring Analyst at FINRA and has more than 30 years of auditing/compliance experience in the securities industry. As a Risk Monitoring Analyst in the Capital Markets and Investment Banking group, Mr. Schmidt acts as the primary point of contact for FINRA member firms and supports FINRA's regulatory program by reviewing firm submissions (FOCUS, Annual Audits, Notifications, Rule 4530 filings, etc.), conducting various risk monitoring activities, and evaluating the impact of material changes to a firm, including changes in key officers, ownership and/or business operations. Prior to joining FINRA in 2014, Mr. Schmidt held various managerial positions at the NYSE over a span of 25 years, including Accounting Supervisor, Managing Director of Internal Audit/Regulatory Quality Review, and Managing Director of Listings Compliance where he was also a voting member of the NYSE Listing and Compliance Committee. Mr. Schmidt was also a member of the Human Resources Advisory Committee and was among the employees that rang the opening bell at the NYSE on August 14, 2006 in recognition of his volunteer work for the PBS Pledge Drive.

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FINRA's Membership Application Program (MAP)

Panelists

- **Moderator**
  - Leyna Goro, Associate District Director, MAP, FINRA Member Supervision
- **Panelists**
  - Patricia Dorilio, Associate District Director, MAP, FINRA Member Supervision
  - Kayla Martin, Examiner, MAP, FINRA Member Supervision
  - Robert Schmidt, Principal Analyst, Risk Monitoring – Jericho Office, FINRA Member Supervision

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To Access Polling

- **Please get your devices out:**
  - Type the polling address, **https://finra.cnf.io/sessions/pz1s** into the browser or scan the QR code with your camera.



  - Select your polling answers.

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Polling Question

1. **For purposes of our Q&A segment today, on which topic(s) would you prefer to see the most focus?**
   a. Ownership changes
   b. Substantial completeness
   c. Asset transfers
   d. Business line expansions



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Advertising Regulation Update
Tuesday, October 5
11:45 a.m. – 12:15 p.m.

Join FINRA staff and industry panelists as they discuss current advertising compliance issues. Panelists also share tips to strengthen the marketing and compliance relationship when developing compliant communications.

Moderator:
Amy Sochard
Vice President, Advertising Regulation
FINRA Advertising Regulation

Panelists:
Ira Gluck
Director, Advertising Regulation
FINRA Advertising Regulation

Minh Le
Director, Private Placements
FINRA Corporate Financing

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Advertising Regulation Update Panelist Bios:

Moderator:



Amy C. Sochard is Vice President of FINRA's Advertising Regulation Department. The department helps protect investors by ensuring members of FINRA use communications including social media, digital advertising and other marketing material that are fair, balanced, and not misleading. Ms. Sochard oversees the department's regulatory review programs and business operations, including the development of technology to facilitate the review of communications. Ms. Sochard provides expertise and policy guidance to other FINRA departments concerning FINRA, SEC, MSRB and SIPC rules pertaining to communications with the public. She also oversees the development of new rules, published guidance, and interpretations regarding communications, and she routinely speaks at industry events on these topics. Prior to joining FINRA, Ms. Sochard worked with a real estate syndication firm in Washington, DC. She received a bachelor's degree with distinction in English from the University of Virginia and studied poetry writing at Columbia University.

Panelists:



Ira Gluck is Director in FINRA's Advertising Regulation Department. In this role, he works on rulemaking and policy issues and is responsible for the Department's complex review and spot-check programs. Mr. Gluck's previous positions within FINRA included leading the Emerging Regulatory Issues team as well as heading the Strategic Initiatives Group in FINRA's Enforcement Department. He also served in various investigative and management roles in the Enforcement and Member Regulation Departments of NASD before its 2007 consolidation with NYSE Member Regulation, which resulted in the formation of FINRA. Mr. Gluck received his bachelor's degree from the University of Pennsylvania and completed both a master's degree and M.B.A. at the University of California, Irvine.



Minh Q. Le is Director of FINRA's Corporate Financing Department. He has more than 20 years of experience in the regulation of public and private offerings. Currently, Mr. Le manages the department's Private Placement Review program which conducts regulatory oversight of broker-dealer participation in retail private offerings. In addition to overseeing the review and investigation program, Mr. Le's duties include developing policy and providing guidance on corporate financing and other capital-raising related issues. Mr. Le also routinely provides subject matter expertise to FINRA's Examination and Enforcement staffs. Building on this experience, Mr. Le serves as a member on FINRA's Regulatory Specialist committees for Public Offerings, Private Placements, and Non-traded Direct Participation Programs (DPP) and Real Estate Investment Trusts (REIT), and was a member of FINRA's Risk Assessment Committee. For the past 19 years, he has been a member of FINRA's Sales Rep and DPP/REIT Qualifications Committees. Prior to his involvement in developing FINRA's private placement rules and the filing program, Mr. Le was a manager in the department's Public Offerings Review program, which is responsible for regulating underwriting terms and arrangements in public offerings. Mr. Le graduated from the University of Maryland, attended the Wharton Institute of Executive Education, and is a Certified Regulatory and Compliance Professional (CRCP)®.

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Advertising Regulation Update

Panelists

- **Moderator**
  - Amy Sochard, Vice President, Advertising Regulation, FINRA Advertising Regulation
- **Panelists**
  - Ira Gluck, Director, Advertising Regulation, FINRA Advertising Regulation
  - Minh Le, Director, Private Placements, FINRA Corporate Financing

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Communications With the Public

- **Digital Video Marketing**
- **Public Appearances**
  - Online Conferencing Tools
  - Supervision
  - Record Keeping
- **Hyperlinks**

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Private Placement Communications

- **New Filing Requirements**
  - FINRA Rules 5122 and 5123
  - Effective Date
  - FAQ
- **FINRA Rule 2210, Communications With the Public**
  - Targeted Returns
  - Internal Rate of Return (IRR)
  - GIPS

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Resources

- FINRA *Regulatory Notice 20-21* – FINRA Provides Guidance on Retail Communications Concerning Private Placement Offerings
  - *www.finra.org/sites/default/files/2020-06/Regulatory-Notice-20-21.pdf*
- FINRA *Regulatory Notice 21-26* – FINRA Amends Rules 5122 and 5123 Filing Requirements to Include Retail Communications That Promote or Recommend Private Placements
  - *www.finra.org/sites/default/files/2021-07/Regulatory-Notice-21-26.pdf*
- Frequently Asked Questions Related to Filing Requirements of Rules 5122 and 512
  - *www.finra.org/rules-guidance/guidance/faqs/finra-rules-5122-5123*

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Introduction to Your Capital Markets and Investment Banking Single Points of Accountability (SPoAs)
Tuesday, October 5
1:30 p.m. – 2:00 p.m.

During this session, FINRA staff discuss the firm grouping structure and lessons learned during implementation. Panelists share what firms can expect going forward.

Speakers:

Elliot Henslovitz
Senior Director, Risk Monitoring – Jersey City Office
FINRA Member Supervision

Robert Sulik
Senior Director, Risk Monitoring – Boston Office
FINRA Member Supervision

Laura Trotz
Senior Director, Risk Monitoring – Chicago Office
FINRA Member Supervision

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Introduction to Your Capital Markets and Investment Banking Single Points of Accountability (SPoAs) Panelist Bios:

Speakers:



Elliot H. Henslovitz is Senior Director of Risk Monitoring assigned to the Capital Markets Niche and Institutional Private Placement firms, as well as the registered Funding Portals. Mr. Henslovitz has been with FINRA since January 2018 and was previously the Senior Director of Surveillance for New York District 10. Prior to joining FINRA, Mr. Henslovitz was the Executive Director and Group Compliance Manager for UBS Americas, where he was responsible for Policy, Training, Employee Conduct, Conduct Risk and Supervisory Controls. Mr. Henslovitz previously served as Senior Division Counsel for UBS Financial Services, Inc. Prior to joining UBS, Mr. Henslovitz was the Senior Vice President and Regional Counsel for Prudential Securities, Incorporated; Deputy Attorney General for the State of New Jersey; and Deputy General Counsel for the Florida Department of Business Regulation. Mr. Henslovitz also worked in private practice as a litigation associate. Mr. Henslovitz earned his undergraduate degree from Yeshiva University and JD from the University of Miami.



Robert M. Sulik has been with FINRA for 34 years and is located in the Boston Office location. He is currently a Single Point of Accountability for Capital Markets M&A Investment Banking group which entails approximately 725 member firms. In this role that began in January 2020, he oversees the risk monitoring team and will coordinate with examination program management on the execution of examinations for the group. More specifically this involves the ongoing risk monitoring and risk assessment of members firms, as well as the planning and execution of examinations. Previous management roles at FINRA have included being a Surveillance Director and an Associate Director in the Boston office for the past 20 years. He worked in other FINRA locations as well, having been an Examiner in the Cleveland and Denver offices and an Examination Manager in the San Francisco office. Mr. Sulik has a bachelor's degree in Finance from Miami University Oxford, Ohio and a master's degree in Finance from University of Colorado Denver.



Laura Trotz is Senior Director for the Capital Markets and Investment Banking firms whose primary business models are Product Origination and Wholesale and Public Finance. Ms. Trotz is responsible for overseeing the ongoing risk monitoring and assessment for these firms as well as coordinating with Examination Program Management on the execution of examinations. Ms. Trotz began her FINRA career more than 20 years ago as an examiner and has held various management roles within the firm, cause, membership and surveillance programs, most recently as District Director for the Chicago District Office. She received her Finance degree from Illinois Benedictine College and holds the Certified Regulatory Compliance Professional™ (CRCP™) certificate from the FINRA Institute at Wharton.

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Introduction to Your Capital Markets and Investment Banking Single Points of Accountability (SPoAs)

Speakers

- **Speakers**
  - Elliot Henslovitz, Senior Director, Risk Monitoring – Jersey City Office, FINRA Member Supervision
  - Robert Sulik, Senior Director, Risk Monitoring – Boston Office, FINRA Member Supervision
  - Laura Trotz, Senior Director, Risk Monitoring – Chicago Office, FINRA Member Supervision

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Financial Rule Updates
Tuesday, October 5
2:15 p.m. – 3:00 p.m.

This session provides an update on financial rules affecting Capital Markets and Investment Banking firms. Join FINRA staff as they discuss the ASC 606 revenue recognition standard, annual audits, expense sharing arrangements, permanency of capital, and exemption reporting.

Moderator:
Ann Duguid
Senior Director
FINRA Office of Financial and Operational Risk Policy

Panelists:
Alif Dhanidina
Senior Principal Analyst, Risk Monitoring – Los Angeles Office
FINRA Member Supervision

Pamela Moy
Principal Analyst, Risk Monitoring – San Francisco Office
FINRA Member Supervision

Anthony Vinci
Director Accounting Policy
FINRA Office of Financial and Operational Risk Policy

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Financial Rule Updates Panelist Bios:

Moderator:



Ann Duguid is Senior Director in the Office of Financial and Operational Risk Policy. In this role, she works closely with FINRA's Member Supervision team providing both accounting policy and financial and operational interpretive guidance related to both introducing and clearing broker dealers. Prior to joining FINRA, Mrs. Duguid worked at J.P. Morgan & Co., where she held various positions, including legal entity controller of J.P. Morgan Securities LLC., regulatory reporting manager (SEA 15c3-1, 15c3-3 and CFTC regulatory reporting), line of business controller for U.S. futures and options clearing and global OTC derivatives brokerage businesses. A Certified Public Accountant with more than 25 years of experience, Ms. Duguid began her career as an auditor at Arthur Andersen & Co. She holds a BBA in Accounting and Management Information Systems from Loyola College in Baltimore, MD.

Panelists:

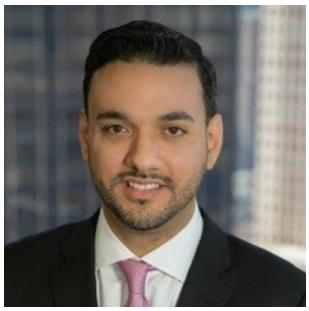


Alif Dhanidina is Principal Regulatory Coordinator in the Los Angeles District Office of FINRA. Mr. Dhanidina's responsibilities include conducting risk assessments of member firms, planning firm examinations, and conducting firm examinations. Prior to joining FINRA, Mr. Dhanidina spent seven years as 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.



Pamela Moy rejoined FINRA in April 2020 as Risk Monitoring Analyst in the San Francisco office in the Capital Markets Group. Prior to rejoining FINRA, Ms. Moy was employed with Morgan Stanley as a Complex Risk Officer for three years where she was responsible for serving as primary contact for all risk, supervisory and compliance functions for San Francisco and Hawaii branches including over 100 Financial Advisors and their retail sales activity and collaborating with their Legal Division for complaint resolution, litigation and Financial Advisor conduct escalation when appropriate. From June 2006 to June 2017, Ms. Moy was the Chief Compliance Officer for Bankoh Investment Services, Inc. where she was responsible for the overall compliance program of the firm including establishing and maintaining the written compliance policies and supervisory procedures, performing training and testing to ensure firm and associated employees were in compliance with firm policies, securities rules and regulations and provided guidance and collaborated with parent, Bank of Hawaii for risk areas such as vendor management, privacy and AML, managed the reviews Bankoh Investment Services, Inc.'s branch offices, in addition to desk reviews and functional reviews at the OSJ. Ms. Moy was employed with NASD from 1998 to 2005 as a securities examiner in the New York and San Francisco offices conducting complex exams and training new staff on the exam process. Prior to NASD, Ms. Moy was a Client Service Associate in the Global Custody Department of Brown Brothers Harriman & Co., acting as liaison between brokerage operations team and account managers and resolved trade inquiries. Prior to Brown Brothers Harriman & Co., Ms. Moy was recruited by U.S Trust through college where she began her professional career in the securities industry. She worked as an Operations Representative in the Liquidations and Legal Transfer unit of U.S. Trust for the John Nuveen UIT and ETF transfer agent division. Ms. Moy graduated from Baruch College, City University of New York with a degree in Management.

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Anthony Vinci is Director in the Office of Financial and Operational Risk Policy at FINRA, working on broker-dealer accounting, auditing, and financial responsibility rule matters. Mr. Vinci is a Certified Public Accountant in the State of New York and currently serves as FINRA's U.S. GAAP subject matter expert. Prior to joining FINRA, Mr. Vinci's career experience was split between public accounting and the broker-dealer industry. Immediately prior to joining FINRA, he was the Chief Financial Officer, Treasurer and Financial and Operations Principal of Mirae Asset Securities USA, Inc. (Mirae), a start-up prime brokerage and clearing/carrying broker-dealer, responsible for building Mirae's financial control, external/internal reporting, and liquidity risk management functions. Prior to his time with Mirae, Mr. Vinci was Chief Financial Officer, Financial and Operations Principal, and Secretary of Maple Securities USA, Inc. (Maple), a self-clearing broker-dealer. Prior to his time at Maple, Mr. Vinci held various positions at GFI Group, Inc., a publicly traded interdealer broker-dealer, including Director of Global Cash Management/Corporate Treasury and Manager of SEC Reporting/Accounting Policy. Mr. Vinci started his career with Ernst & Young LLP in the Financial Services Office Assurance Practice, focused on the audits of publicly traded companies including broker-dealers, securities exchanges, and other financial institutions. Mr. Vinci holds a Bachelor of Business Administration *summa cum laude* and Master of Business Administration with a concentration in Public Accounting and Financial Management from Pace University. He currently serves on the Pace University Lubin School of Business Accounting Department Advisory Board. Mr. Vinci was recently recognized by the New York State Society of Certified Public Accountants with the "Emerging Leader Under 40" award.

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Financial Rule Updates

Panelists

- **Moderator**
  - Ann Duguid, Senior Director, FINRA Office of Financial and Operational Risk Policy
- **Panelists**
  - Alif Dhanidina, Senior Principal Analyst, Risk Monitoring – Los Angeles Office, FINRA Member Supervision
  - Pamela Moy, Principal Analyst, Risk Monitoring – San Francisco Office, FINRA Member Supervision
  - Anthony Vinci, Director Accounting Policy, FINRA Office of Financial and Operational Risk Policy

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Cybersecurity and Closing Remarks
Tuesday, October 5
3:15 p.m. – 4:05 p.m.

This session focuses on cybersecurity issues and common challenges for all size firms. Panelists discuss the current threat landscape including imposter websites, phishing intrusions, ransomware, account takeovers among others, along with effective practices firms can follow.

Moderator:
David Kelley
Director, Member Supervision Specialist Program, Cybersecurity Program
FINRA Member Supervision

Panelists:
Keith Bettencourt
Specialist Manager, Member Supervision Specialist Program, Cybersecurity Program
FINRA Member Supervision

Robert Gnoinski
Director, Risk Monitoring – Kansas City Office
FINRA Member Supervision

Heather Watson
Principal Risk Specialist, Member Supervision Specialist Program, Cybersecurity Program
FINRA Member Supervision

Speaker:
William St. Louis
Senior Vice President, Firm Group Leader – Brookfield Office
FINRA Member Supervision

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Cybersecurity and Closing Remarks Bios:

Moderator:



Dave Kelley, Director, Member Supervision Specialist Programs, is based out of FINRA's Kansas City office. He has been with FINRA for more than 11 years and leads the specialist team dealing with cybersecurity and information technology controls. Prior to joining FINRA, he worked for more than 19 years at American Century Investments in various positions, including Chief Privacy Officer, Director of IT Audit, Director of Electronic Commerce Controls and AML Officer. He led the development of website controls, including customer application security, ethical hacking programs and application controls. Mr. Kelley is a CPA and Certified Internal Auditor, and previously held the Series 7 and 24 licenses.

Panelists:



Keith Bettencourt has been with FINRA as Exam Manager since 2017 in the Long Island Office and Retail Firm Grouping before joining the Cybersecurity team in 2020. Prior to FINRA, Mr. Bettencourt was most recently a Compliance Director at First Empire Securities, Inc. an institutional fixed income BD, and before that worked in the Compliance Department at Capital One Investing for seven years. There he held several positions including serving as its Chief Compliance Officer in 2016, where he was responsible for the traditional bank-BD and self-directed online (f/k/a Sharebuilder) platforms. Mr. Bettencourt led several technology-based efforts while at Capital One, including acting as Data Steward for the firm's compliance applications, leading the compliance and regulatory governance (GRC) efforts, implementation and ongoing monitoring of the firm's vendors, and served as compliance advisor on the firm's agile technology development teams. Prior to Capital One, Mr. Bettencourt held compliance and supervisory positions at HSBC Securities, and was a Sales Practice Review Unit examiner on the Risk Team at NYSE Regulation in 2006. Mr. Bettencourt 's career in supervision and compliance began at Edward Jones in St. Louis in 2003 where he supervised approximately 125 RRs while also performing branch inspections. He has held other operational and sales positions with SWS Securities, First Union Securities, and PaineWebber. Mr. Bettencourt graduated from Oswego State University with a Bachelor of Arts in Public Justice. He holds CISA, CAMS, and CFE designations, and has also served as an industry arbitrator with FINRA Dispute Resolution. He also holds an Information Security and Risk Management certificate program from the University of Washington.



Robert D. Gnoinski is Risk Monitoring Director for Capital Market firms and is located in the Kansas City Office where he supervises a team of Risk Monitoring Analysts in understanding firm business activities and the related risks. Mr. Gnoinski has been with the organization since 2004 and began his career in the Boston Office as an Examiner conducting routine examinations of member firms. Prior to joining FINRA, Mr. Gnoinski worked in a branch office of a member firm in operations and compliance. He holds a B.A. in Management from Hartwick College in Oneonta, NY, and received a finance and accounting certificate from the Wharton School through the Wharton Programs for Working Professionals.

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Heather Watson joined FINRA in October 2007 as an Examiner (now Principal Risk Specialist), based out of the Boston Office, conducting examinations of our member firms. During the past few years, she has conducted several cybersecurity reviews as part of larger Sales Practice examinations or in coordination with FINRA's Cybersecurity Team. In September of 2020, Ms. Watson joined FINRA's Cybersecurity Specialist Team and now leads cybersecurity reviews and advises other FINRA staff. Prior to joining FINRA, Ms. Watson spent 10 years with Boston Financial, working in various operations areas as well as in the compliance department, in both supervisory and risk analyst roles. Ms. Watson holds a BSBA in Finance from Northeastern University and also has her Certified Anti-Money Laundering Specialist (CAMS) certification.

Closing Remarks Speaker:



Bill St. Louis is Senior Vice President and Firm Group Leader for FINRA member firms assigned to the Retail and Capital Markets firm groupings. In this capacity, he has responsibility for the Single Points of Accountability and Risk Monitoring Program teams for these firms, which includes the assessment of business conduct, financial, operational and trading risks. He and his team are also responsible for examination strategy for these firms, as well as coordination with Examination Program management on the execution of related examinations. He also oversees FINRA's High Risk Representative Program, and FINRA's Membership Application Program (MAP). Prior to his current role, Mr. St. Louis was the Regional Director for FINRA's Northeast region, District Director of FINRA's New York office, and held senior roles in FINRA's Enforcement Department including serving as the Regional Chief Counsel for FINRA's North Region. Mr. St. Louis earned an undergraduate degree from Baruch College and a law degree from New York University School of Law. Prior to law school he worked for several years in the Compliance Department of a NY-based broker-dealer.

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Cybersecurity and Closing Remarks

Speakers

- **Moderator**
  - David Kelley, Director, Member Supervision Specialist Program, Cybersecurity Program, FINRA Member Supervision
- **Panelists**
  - Keith Bettencourt, Specialist Manager, Member Supervision Specialist Program, Cybersecurity Program, FINRA Member Supervision
  - Robert Gnoinski, Director, Risk Monitoring – Kansas City Office, FINRA Member Supervision
  - Heather Watson, Principal Risk Specialist, Member Supervision Specialist Program, Cybersecurity Program, FINRA Member Supervision
- **Speaker**
  - William St. Louis, Senior Vice President, Firm Group Leader – Brookfield Office, FINRA Member Supervision

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Cybersecurity and Closing Remarks
Tuesday, October 5
3:15 p.m. – 4:05 p.m.

Resources

FINRA Resources

- FINRA's Cybersecurity Webpage

  www.finra.org/industry/cybersecurity

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