Welcome Remarks and Retail Firm Examinations: Insight into Reviews and What to Expect
Thursday, December 9
10:00 a.m. – 10:45 a.m.

Join FINRA staff as they discuss the most common deficiencies noted during routine FINRA examinations of retails firms. During the session, FINRA staff will share proactive tips, tools, and reviews firms can implement to avoid these deficiencies.

Opening Speaker: John Hickey
Senior Director, Examination – Jersey City Office
FINRA Member Supervision

Moderator: John Hickey
Senior Director, Examination – Jersey City Office
FINRA Member Supervision

Panelists: Philip Koszulinski
Examination Director – Woodbridge Office
FINRA Member Supervision

Yuliana Landers
Examination Manager – Denver Office
FINRA Member Supervision

John Macharia
Examination Manager – Atlanta Office
FINRA Member Supervision

Welcome Remarks and Retail Firm Examinations: Insight into Reviews and What to Expect
Panelist Bios:

Moderator:

John Hickey is currently Senior Director in the Retail firm grouping. In this role, Mr. Hickey leads and manages a team that has responsibility for the execution of examinations in the retail firm grouping. Prior to this role, Mr. Hickey served as the Deputy District Director for the FINRA New York District Office. In that role, he supported the Director in leading and managing the Cycle and Branch regulatory programs for approximately 1000 member firms. Mr. Hickey has more than 22 years of regulatory experience while employed at FINRA and prior to that at NASD and has worked as an examiner, supervisor and manager during his career. Before joining NASD, he spent three years in the Operations Department at a clearing firm, where he worked in the Margin Department. Mr. Hickey has a bachelor's degree in Management from University of Rhode Island. Mr. Hickey also holds the Certified Regulatory and Compliance Professional™ (CRCP™) designation.

Panelists:

Philip Koszulinski is Examination Director in FINRA's Member Supervision Firm Examination program. Mr. Koszulinski is responsible for supervising multiple teams conducting risk-based firm examinations in the Retail Firm Grouping. Mr. Koszulinski has been with FINRA for nine years and has served in various management and examiner roles within Member Supervision. Prior to joining FINRA, Mr. Koszulinski worked as a Financial Analyst at Goldman Sachs & Co. in the Investment Management Division - Private Wealth Management and obtained a bachelor's degree in finance from Drexel University.

Yuliana Landers is Examination Manger for FINRA's Member Supervision examination program. In this capacity, she has responsibility for managing a team that executes examinations of member firms who primarily service retail customers. Throughout her 10-year tenure at FINRA, Ms. Landers has held positions ranging from Compliance Examiner to Examination Manager. Ms. Landers began her career in Consumer and Small Business Banking with Wells Fargo Bank before obtaining her FINRA Series 7 and 66 licenses and transitioning to Wells Fargo Advisors. She received her Bachelor of Arts in Economics from Wartburg College and her Master of Science in Finance from University of Colorado. She is a member of the Association of Certified Anti-Money Laundering Specialists and serves as a Director for the Cancer League of Colorado Foundation.

John Macharia is Examination Manager in the FINRA's Retail Firm Group. He started his career with FINRA as an Examiner 20 years ago. Prior to his current role, Mr. Macharia worked in Risk Monitoring and was responsible for conducting ongoing risk assessments of FINRA members. He is currently responsible for a team of five staff members who conduct cycle examinations. Mr. Macharia previously worked in the industry where he was a Compliance Supervisor with a Series 24 and 27 licenses. He is a graduate of Washburn University in Topeka, Kansas and earned a M.B.A. from the University of Georgia's Terry School of Business.

Welcome Remarks and Retail Firm Examinations: Insight into Reviews and What to Expect

Panelists

- **Opening Speaker**
  - John Hickey, Senior Director, Examination – Jersey City Office, FINRA Member Supervision
- **Moderator**
  - John Hickey, Senior Director, Examination – Jersey City Office, FINRA Member Supervision
- **Panelists**
  - Philip Koszulinski, Examination Director – Woodbridge Office, FINRA Member Supervision
  - Yuliana Landers, Examination Manager – Denver Office, FINRA Member Supervision
  - John Macharia, Examination Manager – Atlanta Office, FINRA Member Supervision

Regulatory Notice 21-20

FINRA Alerts Firms to Phishing Email Using "gateway-finra.org" Domain Name

June 7, 2021

Notice Type

- Special Alert

Suggested Routing

- Legal
- Legal and Compliance
- Risk Management
- Senior Management

Key Topics

- Cybersecurity
- Fake FINRA domain name
- Fraud

Summary

FINRA warns member firms of an ongoing phishing campaign that involves fraudulent emails (see sample in Appendix) purporting to be from FINRA and using the domain name "@gateway-finra.org." The email asks the recipient to click a link to "view request" and provide information to "complete" that request, noting that "late submission may attract penalties."

FINRA recommends that anyone who clicked on any link or image in the email immediately notify the appropriate individuals in their firm of the incident.

The domain of "gateway-finra.org" is not connected to FINRA and firms should delete all emails originating from this domain name.

FINRA reminds firms to verify the legitimacy of any suspicious email prior to responding to it, opening any attachments or clicking on any embedded links.

FINRA has requested that the Internet domain registrar suspend services for "gateway-finra.org."

For more information, firms should review the resources provided on FINRA's Cybersecurity Topic Page, including the Phishing section of our Report on Cybersecurity Practices – 2018.

Questions regarding this *Notice* should be directed to:

- Dave Kelley, Director, Member Supervision Specialist Programs, at (816) 802-4729 or by email; or
- Greg Markovich, Senior Principal Risk Specialist, Member Supervision Specialist Programs, at (312) 899-4604 or by email.

Appendix

From: Name <name@gateway-finra.org>
Date: Monday, June 7, 2021 at 1:25 PM
To: Name <name@firmname.com>
Subject: New Request for Firm Name

FINRA: NEW REQUEST FOR [redacted]

View Request

Case	Request ID	Date Requested	FINRA Requester
202106980000	3989971	06/07/2021	[redacted]

Dear Richard,

A Firm Compliance Request has been issued by FINRA for your firm [redacted]

Follow the information in the letter above to complete the request. Late submission may attract penalties.

Please respond to this email for additional information.

Sincerely,

[redacted]
Principal Compliance Examiner
Financial Industry Regulatory Authority (FINRA)
1735 K Street, NW
Washington, DC 20006

If any documents responsive to this request include BSA Confidential Information, please include the terms "BSA Confidential Material" in the title of the document. BSA Confidential Information includes Suspicious Activity Reports (SARs) and information revealing the existence of 1) a specific SAR or 2) a member firm's affirmative decision not to file a SAR.

Regulatory Notice 21-30

FINRA Alerts Firms to a Phishing Email Campaign Using Multiple Imposter FINRA Domain Names

August 13, 2021

Notice Type
- Special Alert

Suggested Routing
- Legal
- Legal and Compliance
- Risk Management
- Senior Management

Key Topics
- Cybersecurity
- Fake FINRA domain name
- Fraud

Summary

FINRA warns member firms of an ongoing phishing campaign that involves fraudulent emails (see sample in Appendix) purporting to be from FINRA and using one of at least three imposter FINRA domain names:

- "@finrar-reporting.org"
- "@Finpro-finrar.org"
- "@gateway2-finra.org"

The email asks the recipient to click a link to "view request" and provide information to "complete" that request, noting that "late submission may attract penalties."

FINRA recommends that anyone who clicked on any link or image in the email immediately notify the appropriate individuals in their firm of the incident.

None of these domain names are connected to FINRA and firms should delete all emails originating from any of these domain names.

FINRA reminds firms to verify the legitimacy of any suspicious email prior to responding, opening any attachments or clicking on any embedded links.

FINRA has requested that the relevant Internet domain registrars suspend services for all three domain names.

For more information, firms should review the resources provided on FINRA's Cybersecurity Topic Page, including the Phishing section of our Report on Cybersecurity Practices - 2018.

Questions regarding this *Notice* should be directed to:

- Dave Kelley, Director, Member Supervision Specialist Programs, at (816) 802-4729 or David.Kelley@finra.org; or
- Greg Markovich, Senior Principal Risk Specialist, Member Supervision Specialist Programs, at (312) 899-4604 or Gregory.Markovich@finra.org.

FINRA

Appendix

From: *FINRA staff name* <*finra staff name@finrar-reporting.org*>
Sent: Thursday, August 12, 2021 10:34 AM
To: recipient <*recipient@firm name.com*>
Subject: *Firm Name*

Note: Other imposter FINRA domain names may appear here

FINRA: NEW REQUEST

View Request [cshtyaujon.com]

File	ID	Date Requested	Requester
202108950000 [cdpn.io]	3099971 [cdpn.io]	08/12/2021	*FINRA staff name*

Dear recipient,

As a way of introduction, my name is *FINRA staff name* and I work in the area of The Financial Industry Regulatory Authority (FINRA) which is responsible for the regulation of your firm.

In line with a new directive released to all FINRA regulated firms, the following request(s) has been provided for your firm. Kindly follow the information in the letter and complete the request by yourself. Late submission may attract penalties.

Sincerely,

FINRA staff name
Senior Vice President - Member Supervision
Financial Industry Regulatory Authority (FINRA).
1735 K Street, NW
Washington, DC 20006
xxx-xxx-xxxx

FINRA

FEBRUARY 2021

2021 Report on FINRA's Examination and Risk Monitoring Program

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.

www.finra.org

21_0021.1—02/21

Introduction to Your Retail Single Points of Accountability (SPoAs)
Thursday, December 9
11:00 a.m. – 11:30 a.m.

During this session, FINRA SPoAs discuss the firm grouping structure. Panelists provide insight into their roles and how they interact with firms.

Moderator:
Andrew McElduff
Senior Director, Risk Monitoring – Brookfield Office
FINRA Member Supervision

Panelists:
Lance Burkett
Senior Director, Risk Monitoring – Denver Office
FINRA Member Supervision

Robert Chao
Senior Director, Risk Monitoring – Jericho Office
FINRA Member Supervision

Elizabeth Page
Vice President, Firm Group Risk Monitoring – Boston Office
FINRA Member Supervision

Introduction to Your Retail Single Points of Accountability (SPoAs) Panelist Bios:

Moderator:

Andrew McElduff is Senior Director and Single Point of Accountability (SPOA) of Risk Monitoring within the Retail Firm Group for FINRA's Member Supervision Department. In his role, Mr. McElduff oversees three Risk Monitoring teams responsible for monitoring and assessing risk across the Retail - Private Placement and Retail – Pooled Investment & Variable Annuity firms. Mr. McElduff is also responsible for, and partners with the Examination program leaders, determining the annual exam plan and the appropriate scope of each exam within the Private Placement and Pooled Investment & Variable Annuity firms. Prior to his role in Risk Monitoring, Mr. McElduff oversaw Examination teams in FINRA's New York office. Those teams were responsible for conducting the cycle, branch, and cause examinations of member firms across all firm sizes and business lines. Mr. McElduff joined FINRA in September 2007 after working at a startup handling day to day operations and managing a national sales team. Mr. McElduff is a graduate of the University of North Carolina at Chapel Hill.

Panelists:

Lance Burkett is Senior Director of Risk Monitoring in the FINRA Denver Office. He began his securities industry career in 1993 as a Securities Fraud Investigator for the State of Arizona Securities Division, working exclusively on fraud cases involving broker-dealers. Later, at a FINRA member firm, he was responsible for supervising Producing Branch Managers and Field Representatives as the Field Compliance Director. Throughout his tenure with FINRA, Mr. Burkett has held positions ranging from Compliance Examiner, District Director and now Senior Director - Risk Monitoring, responsible in overseeing the Risk Monitoring team and coordinating with the Examination Program Management on the execution of examinations of Member firms in the retail space. Mr. Burkett earned his Certified Regulatory and Compliance Professional™ designation through the FINRA Institute at Wharton and has developed content and presented at several FINRA Institute class offerings.

Robert Chao is Senior Director, FINRA Member Supervision. He is responsible for firms in the Retail-Fintech and Retail-Carrying and Clearing groups. Mr. Chao is currently on the Correspondent Clearing committee, eFocus Redesign committee, and the Behavioral Science Working Group within FINRA. He was formerly a Surveillance Director and an Examination Director and has been at FINRA since 2009. Mr. Chao joined FINRA from UBS Financial Services, Inc., where he worked from 2007 to 2009, serving as a Director responsible for financial and regulatory reporting. Prior to joining UBS, he was a Vice President in the Finance group at J.P. Morgan Securities Inc. He was with the NYSE from 1994 to 1997 as an Examiner in Member Firm Regulation. Mr. Chao received his Bachelor of Science in Finance at New York University and was previously a registered principal holding series 7, 9/10, and 27 licenses.

Elizabeth Page is Vice President and Single Point of Accountability for Retail Firms that are Independent Contractors. In this role, Ms. Page's responsibilities include overseeing the risk monitoring teams responsible for the ongoing risk monitoring and risk assessment of independent contractor firms and coordinating with the Examination Program Management on the planning and execution of examinations. Prior to this new role, Ms. Page was the Director of FINRA's Boston office and worked in FINRA's Chicago office in a variety of staff and management roles in the membership, surveillance, firm exam and investigations programs. Ms. Page has bachelor's degree in Finance and a Master of Business Administration degree from the University of Denver.

Introduction to Your Retail Single Points of Accountability (SPoAs)

Panelists

- **Moderator**
  - Andrew McElduff, Senior Director, Risk Monitoring – Brookfield Office, FINRA Member Supervision
- **Panelists**
  - Lance Burkett, Senior Director, Risk Monitoring – Denver Office, FINRA Member Supervision
  - Robert Chao, Senior Director, Risk Monitoring – Jericho Office, FINRA Member Supervision
  - Elizabeth Page, Vice President, Firm Group Risk Monitoring – Boston Office, FINRA Member Supervision

Introduction to Your Retail Single Points of Accountability (SPoAs)
Thursday, December 9
11:00 a.m. – 11:30 a.m.

Resource:

- FINRA Podcast: Single Points of Accountability: Navigating Firms' Experiences with FINRA (September 2021)

  www.finra.org/media-center/finra-unscripted/single-point-of-accountability

Fireside Chat
Thursday, December 9
11:45 a.m. – 12:15 p.m.

Fireside Chat featuring FINRA Executive Vice President, Member Supervision Greg Ruppert and Senior Vice President of FINRA's National Cause and Financial Crimes (NCFC) Detection Program Sam Draddy.

Speakers:

Sam Draddy
Senior Vice President, Insider Trading and PIPEs Surveillance
FINRA Member Supervision

Greg Ruppert
Executive Vice President, Member Supervision
FINRA Member Supervision

Fireside Chat Panelist Bios:

Speakers:

Samuel Draddy is Senior Vice President in FINRA's National Cause and Financial Crimes Detection Program and head of FINRA's Insider Trading, Fraud and PIPEs Surveillance Units. Mr. Draddy joined FINRA in 2007 after more than seven years in the Division of Enforcement at the SEC. At the SEC, he was a Senior Counsel in the Division of Enforcement from 1999 through 2004, and then a Branch Chief in SEC Enforcement from 2005 through 2007. Prior to his tenure at the SEC, Mr. Draddy was a criminal prosecutor in the State's Attorney's Office for Baltimore County, MD, from 1994 through 1999. Mr. Draddy was also a Series 7 licensed registered representative at Paine Webber in 1993. Mr. Draddy received his bachelor's degree from Brown University in 1987 and law degree from New York Law School in 1993.

Greg Ruppert, Executive Vice President, leads FINRA's Member Supervision organization, a cohesive group of programs which protect investors and safeguard market integrity through surveillance and oversight of Member Firms and Registered Representatives. In particular, Mr. Ruppert sets the strategic direction of the Member Application Program, Risk Monitoring Program, Firm Examination Program, and Investigative Programs of the organization. Mr. Ruppert joined FINRA in 2020 as the Executive Vice President of FINRA's National Cause and Financial Crimes Detection Program (NCFC) within Member Supervision. In his prior role, Mr. Ruppert oversaw FINRA's National Cause Program, Financial Crimes Surveillance, and Specialized Investigative Units covering vulnerable adults and seniors, anti-money laundering and fraud, high-risk representatives, and cybersecurity. He was also responsible for the creation of FINRA's Financial Intelligence Unit. Prior to joining FINRA, from 2014 to 2020, Mr. Ruppert was a Senior Vice President in Charles Schwab Corporation's Risk Management department. In that role, he led teams responsible for several of the key operational and compliance risk areas across the enterprise. He also served as the Board-appointed Bank Secrecy Act (BSA) Officer and the Corporate Responsibility Officer for the corporation. Prior to joining Schwab, Mr. Ruppert spent more than 17 years with the U.S. Government, achieving the rank of Senior Executive Service. Mr. Ruppert's career as a Special Agent in the FBI included investigator and leadership roles specializing in complex corporate and securities cases, financial crimes, terrorism, and cyber. Mr. Ruppert is a Professor of Practice at the University of the Pacific, School of Engineering and Computer Sciences, for the Data Science Master's Program. He on the Board of Directors of the non-profit organization CalTrout. Previously, he was on the board of the non-profit organization GirlVentures and served as President of the board. Mr. Ruppert has a J.D. from the University of the Pacific's McGeorge School of Law and a B.A. from the University of the Pacific.

Fireside Chat

Speakers

- **Speakers**
  - Sam Draddy, Senior Vice President, Insider Trading and PIPEs Surveillance, FINRA Member Supervision
  - Greg Ruppert, Executive Vice President, Member Supervision, FINRA Member Supervision

Restricted Firm Obligations: What You Need to Know
Thursday, December 9
1:30 p.m. – 2:15 p.m.

Join FINRA staff as they discuss Rule 4111 (Restricted Firm Obligations) which takes effect January 2022. During the session, panelists review the new obligation and criteria for identification.

Moderator:
Lance Burkett
Senior Director, Risk Monitoring – Denver Office
FINRA Member Supervision

Panelists:
Kosha Dalal
Vice President and Associate General Counsel, Legal Policy
FINRA Office of General Counsel

Michael Garawski
Associate General Counsel, Regulatory
FINRA Office of General Counsel

AnnMarie McGarrigle
Director, Risk Monitoring – Philadelphia Office
FINRA Member Supervision

Restricted Firm Obligations: What You Need to Know Panelist Bios:

Moderator:

Lance Burkett is Senior Director of Risk Monitoring in the FINRA Denver Office. He began his securities industry career in 1993 as a Securities Fraud Investigator for the State of Arizona Securities Division, working exclusively on fraud cases involving broker-dealers. Later, at a FINRA member firm, he was responsible for supervising Producing Branch Managers and Field Representatives as the Field Compliance Director. Throughout his tenure with FINRA, Mr. Burkett has held positions ranging from Compliance Examiner, District Director and now Senior Director - Risk Monitoring, responsible in overseeing the Risk Monitoring team and coordinating with the Examination Program Management on the execution of examinations of Member firms in the retail space. Mr. Burkett earned his Certified Regulatory and Compliance Professional™ designation through the FINRA Institute at Wharton and has developed content and presented at several FINRA Institute class offerings.

Panelists:

Kosha Dalal is Vice President and Associate General Counsel for Legal Policy with FINRA's Office of General Counsel. In this role, she provides legal guidance on various policy initiatives and rule changes/interpretations including, supervision, firms and brokers with a history of misconduct, branch office/OSJ, remote inspections, customer account statements, membership application rules, ACATs, payments to unregistered persons and corporate actions. She has been with FINRA's Office of General Counsel since 2000. Prior to coming to FINRA, she was an associate with the law firm of Venable in Baltimore, MD, Kalkines Zall in New York, NY and Skadden Arps in New York, NY. Ms. Dalal holds a BA in Political Science and Economics from Barnard University and a JD from Brooklyn Law School. Ms. Dalal also serves on FINRA's Diversity Leadership Council, which is tasked with recommending steps and initiatives to help FINRA develop and implement a robust diversity and inclusion strategy.

Michael Garawski is Associate General Counsel, Regulatory Practice & Policy, with FINRA's Office of General Counsel. In this role, Mr. Garawski directs and manages the complete life cycle of the adoption of new regulatory requirements, and he advises the FINRA Board of Governors, FINRA advisory committees, and senior FINRA management on regulatory initiatives and rule changes. Previously, he served as Associate General Counsel in FINRA's Appellate Group and as Assistant General Counsel with the Commodity Futures Trading Commission. He is a graduate of Boston College and the George Washington University Law School.

AnnMarie McGarrigle is Risk Monitoring Director for FINRA's Retail – Independent Contractor firms. In her role, she actively manages the regulatory risk-monitoring program and leads a team of six Risk Monitoring Analysts who oversee and monitor retail – independent contractor member firms for compliance with applicable securities rules and regulations. As the Director, Ms. McGarrigle is also responsible for FINRA's efforts to identify and address current and emerging industry risks through the analysis and assessment of a firms' finances, operations, controls and systems. Ms. McGarrigle has a Bachelor of Science degree in Accountancy from Villanova University and is designated as a Certified Regulatory and Compliance Professional™ (CRCP™) through the FINRA Institute.

FINRA Firm Grouping Member Forum:

Retail

December 9, 2021 | Virtual

Restricted Firm Obligations: What You Need to Know

FINRA®

Panelists

- **Moderator**
  - Lance Burkett, Senior Director, Risk Monitoring – Denver Office, FINRA Member Supervision
- **Panelists**
  - Kosha Dalal, Vice President and Associate General Counsel, Legal Policy, FINRA Office of General Counsel
  - Michael Garawski, Associate General Counsel, Regulatory, FINRA Office of General Counsel
  - AnnMarie McGarrigle, Director, Risk Monitoring – Philadelphia Office, FINRA Member Supervision

Regulatory Notice 21-34

Protecting Investors from Misconduct

FINRA Adopts Rules to Address Firms With a Significant History of Misconduct

Effective Date: January 1, 2022

Summary

FINRA has adopted new rules to address firms with a significant history of misconduct.[1] New Rule 4111 (Restricted Firm Obligations) requires member firms that are identified as "Restricted Firms" to deposit cash or qualified securities in a segregated, restricted account; adhere to specified conditions or restrictions; or comply with a combination of such obligations. New Rule 9561 (Procedures for Regulating Activities Under Rule 4111) and amendments to Rule 9559 (Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series) establish a new expedited proceeding to implement Rule 4111.

The new rules and rule amendments become effective on January 1, 2022.

The rule text is available in Attachment A. A flow chart of the Rule 4111 process is available in Attachment B.

Questions concerning this *Notice* should be directed to:

- Kosha Dalal, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-6903 or Kosha.Dalal@finra.org; or
- Michael Garawski, Associate General Counsel, OGC, at (202) 728-8835 or Michael.Garawski@finra.org.

Background and Discussion

FINRA uses a combination of tools to reduce the risk of harm to investors from member firms and the brokers they hire that have a history of misconduct. These tools include assessments of applications member firms file to retain or employ an individual subject to a statutory disqualification, reviews of membership and continuing membership applications, disclosure of brokers' regulatory backgrounds, supervision requirements, focused examinations, risk monitoring and disciplinary actions.

September 28, 2021

Notice Type

- New Rule
- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Operations
- Registered Representatives
- Registration
- Senior Management

Key Topics

- Firms With a Significant History of Misconduct

Referenced Rules & Notices

- Regulatory Notice 18-15
- Regulatory Notice 18-16
- Regulatory Notice 18-17
- Regulatory Notice 20-15
- Regulatory Notice 21-09
- FINRA Rule 3110
- FINRA Rule 4111
- FINRA Rule 8312
- FINRA Rule 8313
- FINRA Rule 9559
- FINRA Rule 9561

For several years, FINRA has been enhancing its programs to address the risks that can be posed to investors and the broader market by individual brokers and member firms that have a history of misconduct. As part of this initiative, FINRA has:

- published *Regulatory Notice 18-15* (Heightened Supervision), which reiterates the existing obligation of member firms to implement for such individuals tailored heightened supervisory procedures under Rule 3110 (Supervision);
- published *Regulatory Notice 18-17* (FINRA Revises the Sanction Guidelines), which announced revisions to the FINRA Sanction Guidelines;
- raised fees for statutory disqualification applications;[2]
- revised the qualification examination waiver guidelines to permit FINRA to more broadly consider past misconduct when considering examination waiver requests;[3] and
- adopted rules concerning brokers with a significant history of misconduct.[4]

New Rule 4111

Rule 4111 addresses risks from broker-dealers with a significant history of misconduct, including firms with a high concentration of individuals with a significant history of misconduct. The rule allows FINRA to impose new obligations on broker-dealers with significantly higher levels of risk-related disclosures than other similarly sized peers, based on numeric, threshold-based criteria. The obligations that can be imposed include a requirement to deposit cash or qualified securities in a segregated, restricted account, and other conditions and restrictions that are necessary or appropriate for the protection of investors and in the public interest. FINRA believes that the direct financial impact of a restricted deposit is likely to change such member firms' behavior—and therefore protect investors.

As explained in detail below, Rule 4111 establishes a multi-step, annual process through which FINRA will determine whether a member firm raises investor protection concerns substantial enough to require that it be designated (or re-designated) as a "Restricted Firm" and subject to additional obligations, including a "Restricted Deposit Requirement." The multi-step process includes numerous features designed to narrowly focus the new obligations on the firms most of concern. Each year's process will begin with a calculation of which firms meet numeric thresholds based on firm-level and individual-level disclosure events to identify member firms with a significantly higher level of risk-related disclosures as compared to similarly sized peers. The process also gives each member firm that is preliminarily identified by these numeric criteria several ways to affect outcomes during subsequent steps in the process. These include a one-time opportunity to avoid the imposition of obligations by voluntarily reducing its workforce; an opportunity to explain

to the Department of Member Supervision (Department) why the firm should not be designated as a Restricted Firm or be subject to a Restricted Deposit Requirement or to propose alternatives that would still accomplish FINRA's goal of protecting investors; and the opportunity to request a hearing before a FINRA Hearing Officer in an expedited proceeding to challenge a Department determination.

As the attached flow chart reflects (Attachment B), the Rule 4111 process is akin to a "funnel." The top of the funnel applies to the range of member firms with the most disclosures, with a narrowing in the middle of the potential member firms that may be subject to additional obligations, and the bottom of the funnel reflecting the smaller number of member firms that are determined to present high risks to the investing public.

An added benefit of Rule 4111 will be important ancillary effects in addressing unpaid arbitration awards. The rule is intended to incentivize firms to improve their practices to avoid being deemed a Restricted Firm in the first place. In addition, the new rule will consider, among other factors, "Covered Pending Arbitration Claims"[5] and unpaid arbitration awards[6] in determining the size of a Restricted Firm's Restricted Deposit Requirement.[7] The new rule also includes a number of presumptions that apply in the Department's assessment of an application by a previously designated Restricted Firm to make a withdrawal from its Restricted Deposit that would further incentivize the payment of arbitration awards.[8]

Explanations of the specific provisions in Rule 4111 are provided below.

General (Rule 4111(a))

Rule 4111(a) requires a member designated as a Restricted Firm to establish a "Restricted Deposit Account"[9] and deposit in that account cash or qualified securities with an aggregate value that is not less than the member firm's Restricted Deposit Requirement, except in certain identified situations. Restricted Firms also could be subject to conditions or restrictions on the member firm's operations as determined by the Department to be necessary or appropriate for the protection of investors and in the public interest, in addition or in alternative to a Restricted Deposit Requirement.

Annual Calculation by FINRA of the Preliminary Criteria for Identification (Rule 4111(b))

The annual multi-step Rule 4111 process will begin with a calculation. As explained below, Rule 4111(b) requires the Department to calculate annually a member firm's "Preliminary Identification Metrics"[10] to determine whether the firm meets the "Preliminary Criteria for Identification."[11] A key driver of that is whether a member firm's Preliminary Identification Metrics meet quantitative, risk-based "Preliminary Identification Metrics Thresholds."[12]

Several principles guided FINRA's development of the Preliminary Criteria for Identification and the Preliminary Identification Metrics Thresholds. The criteria and thresholds are intended to be replicable and transparent to FINRA and affected member firms, employ the most complete and accurate data available to FINRA, be objective, account for different firm sizes and business profiles and target the sales-practice concerns that motivated the new rule. These criteria are intended to identify member firms that present a high risk, but avoid imposing obligations on member firms whose risk profile and activities do not warrant such obligations.

To calculate whether a member firm meets the Preliminary Criteria for Identification, the Department will first compute the Preliminary Identification Metrics for each of six categories of events or conditions, collectively defined as the "Disclosure Event and Expelled Firm Association Categories."[13] These six categories are all based on events or conditions disclosed through the Uniform Registration Forms,[14] with the exception of one event category (Member Firm Adjudicated Events), which also includes events that are derived from customer arbitrations filed with FINRA's dispute resolution forum. The six categories are:

1. Registered Person Adjudicated Events;[15]
2. Registered Person Pending Events;[16]
3. Registered Person Termination and Internal Review Events;[17]
4. Member Firm Adjudicated Events;[18]
5. Member Firm Pending Events;[19] and
6. Registered Persons Associated with Previously Expelled Firms (also referred to as the Expelled Firm Association category).[20]

To calculate each of the six categories' Preliminary Identification Metrics, FINRA first will add the number of pertinent disclosure events or, for the Expelled Firm Association category, the number of the Registered Persons Associated with Previously Expelled Firms. For the adjudicated-events categories, the counts will include disclosure events that were resolved during the prior five years from the Evaluation Date.[21] For the pending-events categories and pending internal reviews, the counts will include disclosure events that are pending as of the Evaluation Date.[22] In addition, for the three Registered Person disclosure-event based categories, the counts will include disclosure events across all "Registered Persons In-Scope," which is defined to include persons registered with the member firm for one or more days within the one year prior to the Evaluation Date.[23]

Each of those six sums will then be standardized to determine the member firm's six Preliminary Identification Metrics. For the five "Registered Person and Member Firm Events" categories (Categories 1-5 above),[24] the Preliminary Identification Metrics are in the form of an average number of events per Registered Persons In-Scope, calculated by taking each category's sum and dividing it by the number of Registered Persons In-Scope.[25] The sixth Preliminary Identification Metric—the Expelled Firm Association Metric—is in the form of a percentage concentration at the member firm of Registered Persons Associated with Previously Expelled Firms. This concentration is calculated by taking the number of Registered Persons Associated with Previously Expelled Firms and dividing it by the number of Registered Persons In-Scope.[26]

A firm's six Preliminary Identification Metrics will then be used to determine if the member firm meets the Preliminary Criteria for Identification. This involves analyzing the extent to which the member firm's Preliminary Identification Metrics meet the specified numeric Preliminary Identification Metrics Thresholds in Rule 4111(i)(11) and meet additional conditions intended to prevent a member firm from becoming potentially subject to additional obligations solely as a result of pending matters or a single event or condition.[27] Each specific numeric threshold in the Preliminary Identification Metrics Thresholds grid in Rule 4111(i)(11) is a number which represents outliers with respect to similarly sized peers for the type of events or conditions in the category (i.e., the firm is at the far tail of the respective category's distribution), which is intended to preliminarily identify member firms that present significantly higher risk than a large percentage of the membership. There are numeric thresholds for seven different firm sizes (ranging from firms with 1-4 Registered Persons In-Scope to 500 or more Registered Persons In-Scope) to ensure that each member firm is compared only to its similarly sized peers.

Specifically, a member firm will meet the Preliminary Criteria for Identification if:

- two or more of the member firm's Preliminary Identification Metrics are equal to or more than the corresponding Preliminary Identification Metrics Thresholds for the member firm's size, and at least one of those Preliminary Identification Metrics is the Registered Person Adjudicated Event Metric, the Member Firm Adjudicated Event Metric, or the Expelled Firm Association Metric;[28] and
- the member firm has two or more Registered Person or Member Firm Events (*i.e.,* two or more events from Categories 1-5 above) during the Evaluation Period.[29]

The following three examples demonstrate—in practical terms—the point at which a member firm's Preliminary Identification Metrics for different categories will meet the Preliminary Identification Metrics Thresholds:

	Preliminary Identification Metrics Thresholds	Practical Equivalent
Example 1 (member firm size between 1-4 Registered Persons In-Scope)	The Preliminary Identification Metrics Threshold for the Registered Person Adjudicated Event Metric, for a member firm that has between one and four Registered Persons In-Scope as of the Evaluation Date, is 0.50 (or 0.50 events per Registered Broker In-Scope).	For a member firm with four Registered Persons In-Scope as of the Evaluation Date, the member will meet the Preliminary Identification Metrics Threshold for the Registered Person Adjudicated Event Metric if the sum of its four Registered Persons In-Scope's Adjudicated Events, which reached a resolution over the five years before the Evaluation Date, was *two or more*. (4 Registered Persons In-Scope) * (0.50 Preliminary Identification Metrics Threshold for the Registered Person Adjudicated Event Metric) = (2 Adjudicated Events)
Example 2 (member firm size between 20-50 Registered Persons In-Scope)	The Preliminary Identification Metrics Threshold for the Member Firm Adjudicated Event Metric, for a member firm that has between 20-50 Registered Persons In-Scope as of the Evaluation Date, is 0.20 (or 0.20 events per Registered Broker In-Scope).	For a member firm with 50 Registered Persons In-Scope as of the Evaluation Date, the member firm will meet the Preliminary Identification Metrics Threshold for the Member Firm Adjudicated Event Metric if the sum of the member firm's Adjudicated Events, which reached a resolution over the five years before the Evaluation Date, was *ten or more*. (50 Registered Persons In-Scope) * (0.20 Preliminary Identification Metrics Threshold for the Member Firm Adjudicated Event Metric) = (10 Adjudicated Events)
Example 3 (member firm size between 51-150 Registered Persons In-Scope)	The Preliminary Identification Metrics Threshold for the Expelled Firm Association Metric, for a member firm that has between 51-150 Registered Persons In-Scope as of the Evaluation Date, is 0.03 (or a 3 percent concentration level).	For a member firm with 100 Registered Persons In-Scope as of the Evaluation Date, the member firm will meet the Preliminary Identification Metrics Threshold for the Expelled Firm Association Metric if the sum of its Registered Persons Associated with Previously Expelled Firms was *three or more*. (100 Registered Persons In-Scope) * (0.03 Preliminary Identification Metrics Threshold for the Expelled Firm Association Metric) = (Three Registered Persons Associated with Previously Expelled Firms)

The annual "Evaluation Date" will establish the date as of which all specified events that are reportable on the Uniform Registration Forms, or otherwise included in Rule 4111, would be included in the annual calculation of the Preliminary Criteria for Identification, not the date as of when the events that are reported would be counted. For example, if a relevant final regulatory action against a registered person occurs just prior to the Evaluation Date but is reported on Form U4 after the Evaluation Date, the annual Preliminary Criteria for Identification calculation would include that disclosure event. Furthermore, the Evaluation Date is not the date when FINRA would actually perform the annual calculation of the Preliminary Criteria for Identification. Rather, FINRA plans to actually perform the annual calculation at least 30 days after the Evaluation Date, to account for the time between when relevant disclosure events occurred and when firms must report those events on the Uniform Registration Forms.

In a separate *Regulatory Notice*, FINRA will announce the first Evaluation Date no less than 120 calendar days before the first Evaluation Date. FINRA expects that the first Evaluation Date will be mid-year 2022. FINRA further expects that subsequent Evaluation Dates will be on the same month and day each year, whether that date certain falls on a business day, weekend or a holiday. However, FINRA will evaluate whether future adjustments of the annual Evaluation Date are warranted and would announce any changes in such date sufficiently in advance.

Before the first Evaluation Date and FINRA's first performing of the annual calculation, FINRA will need to develop new systems and processes to implement Rule 4111. These systems and processes will include, for example, internal systems for FINRA's annual calculations of the Preliminary Criteria for Identification (and the underlying Preliminary Identification Metrics) and systems that facilitate FINRA's Rule 4111 operations. While the development of such technology will require time and resources, FINRA expects that these new systems and processes will add significant value long term by allowing the large volumes of data required to run the annual calculations to be evaluated and analyzed efficiently.

In addition, FINRA will provide several external resources to assist firms. FINRA will maintain on its website a chart that maps the Registered Person and Member Firm Events categories (Categories 1-5 above) to the relevant disclosure questions and fields on the Uniform Registration Forms. FINRA also plans to publish on its website, and keep updated, a list of firms that have been expelled.

Based on feedback from member firms, FINRA also expects to provide a non-determinative calculation (an "early indicator calculation") of the Preliminary Criteria for Identification that will give firms an indication of where they stand as of a specific date in advance of the Evaluation Date. This early indicator calculation would be for informational purposes only to provide firms a signal, and a firm's status as of the Evaluation Date could change significantly based on subsequent activities at the firm. The early indicator calculations

will indicate only whether a firm would meet the Preliminary Criteria for Identification and what a firm's six Preliminary Identification Metrics would be were the annual Rule 4111 calculation to be run as of the specific date used in the early indicator calculation. The results of the early indicator calculations could be used by member firms to monitor their status in relation to the Preliminary Criteria for Identification, including how close a firm's Preliminary Identification Metrics are in relation to the relevant Preliminary Identification Metrics Thresholds, at that specific point in time. As the necessary technology systems are built and tested, FINRA will announce in advance the date it will make available to firms the early indicator calculation and the process and manner by which firms can gain access to their own early indicator calculation.

Initial Department Evaluation (Rule 4111(c)(1))

Following the annual calculation, for each member firm that meets the Preliminary Criteria for Identification as of the Evaluation Date, the Department will conduct, pursuant to Rule 4111(c)(1), an initial internal evaluation to determine whether the member firm does not warrant further review under Rule 4111. In doing so, the Department will review whether the computation of the member firm's Preliminary Identification Metrics included disclosure events or other conditions that are not consistent with the purpose of the Preliminary Criteria for Identification and are not reflective of a firm posing a high degree of risk. For example, the Department may have information that the computation included disclosure events that were not sales-practice related, were duplicative (involving the same customer and the same matter), or mostly involved compliance concerns best addressed by a different regulatory response by FINRA (*e.g.,* enforcement actions, more frequent examination cycles, temporary cease and desist orders). The Department will evaluate the events to determine, among other things, whether they indicated risks to investors or market integrity, rather than, for instance, repeated violations of procedural rules.

The Department will also consider whether the member firm has addressed the concerns signaled by the disclosure events or conditions, or altered its business operations such that the threshold calculation no longer reflects the member firm's current risk profile. Essentially, the purpose of the Department's initial evaluation is to determine whether it is aware of information that would show that the member firm—despite having met the Preliminary Criteria for Identification—does not pose a high degree of risk.

Pursuant to Rule 4111(c)(3), if the Department determines, after this initial evaluation, that the member firm does not warrant further review, the Department will conclude that year's Rule 4111 process for the member firm and would not seek that year to impose any obligations on it. If, however, the Department determines that the member firm does warrant further review, the Rule 4111 process would continue.

One-Time Opportunity to Reduce Staffing Levels (Rule 4111(c)(2))

If the Department determines, after its initial evaluation, that a member firm warrants further review under Rule 4111, such member firm—if it has met the Preliminary Criteria for Identification for the first time—will have a one-time opportunity to reduce its staffing levels to no longer meet these criteria, within 30 business days after being informed by the Department that it met the Preliminary Criteria for Identification. The member firm will be required to demonstrate the staff reduction to the Department by identifying the terminated individuals. Rule 4111(c)(2) will prohibit the member firm from rehiring any persons terminated pursuant to this option, in any capacity, for one year.

If the member reduces its staffing levels, and the Department determines that the member firm no longer meets the Preliminary Criteria for Identification, the Department will close out that year's Rule 4111 process for the member firm. If, on the other hand, the Department determines that the member firm still meets the Preliminary Criteria for Identification even after its staff reductions, the Department will proceed to determine the firm's maximum Restricted Deposit Requirement, and the member firm will proceed to a "Consultation" with the Department.

FINRA's Determination of a Maximum Restricted Deposit Requirement (Rule 4111(i)(15))

The Department would tailor the member firm's maximum Restricted Deposit Requirement amount to its size, operations and financial conditions. As provided in Rule 4111(i)(15), the Department will consider the nature of the member firm's operations and activities, revenues, commissions, assets, liabilities, expenses, net capital, the number of offices and registered persons, the nature of the disclosure events counted in the numeric thresholds, insurance coverage for customer arbitration awards or settlements, concerns raised during FINRA exams and the amount of any of the firm's or its Associated Persons' "Covered Pending Arbitration Claims" or unpaid arbitration awards.[30] Based on a consideration of these factors, the Department will determine a maximum Restricted Deposit Requirement for the member firm that is consistent with the objectives of the rule, but that does not significantly undermine the continued financial stability and operational capability of the member firm as an ongoing enterprise over the next 12 months. FINRA's intent is that the maximum Restricted Deposit Requirement should be significant enough to change the member firm's behavior but not force the member firm out of business solely by virtue of the imposed deposit requirement.[31]

Consultation (Rule 4111(d))

During the Consultation, the member firm will have an opportunity to demonstrate why it does not meet the Preliminary Criteria for Identification, why it should not be designated as a Restricted Firm and why it should not be subject to the maximum Restricted Deposit Requirement. There will be two rebuttable presumptions in a Consultation: That the member firm should be designated as a Restricted Firm; and that it should be subject to the maximum Restricted Deposit Requirement. The member firm will bear the burden of overcoming those presumptions.

Rule 4111(d)(1) governs how a member firm may overcome these two presumptions. First, a member firm may overcome the presumption that it should be designated as a Restricted Firm by clearly demonstrating that the Department's calculation that the member meets the Preliminary Criteria for Identification is inaccurate because, among other things, it included events, in the six categories described above, that should not have been included because, for example, they are duplicative, involving the same customer and the same matter, or are not sales-practice related. Second, a member firm may overcome the presumption that it should be subject to the maximum Restricted Deposit Requirement by clearly demonstrating that the member firm would face significant undue financial hardship if it were subject to the maximum Restricted Deposit Requirement and that a lesser deposit requirement would satisfy the objectives of Rule 4111 and be consistent with the protection of investors and the public interest; or that other conditions and restrictions on the operations and activities of the member firm and its associated persons would address the concerns indicated by the thresholds and protect investors and the public interest.

Rule 4111(d)(2) governs how the Department will schedule and provide notice of the Consultation, and also governs requests for postponements of the Consultation.

Rule 4111(d)(3) provides guidance on what the Department will consider during the Consultation when evaluating whether a member firm should be designated as a Restricted Firm and subject to a Restricted Deposit Requirement. This provision also provides member firms with guidance on how to attempt to overcome the two rebuttable presumptions. Specifically, Rule 4111(d)(3) requires that the Department consider:

- information provided by the member firm during any meetings as part of the Consultation;
- relevant information or documents, if any, submitted by the member firm, in the manner and form prescribed by the Department, as shall be necessary or appropriate for the Department to review the computation of the Preliminary Criteria for Identification;
- any plan submitted by the member firm, in the manner and form prescribed by the Department, proposing in detail the specific conditions or restrictions that the member firm seeks to have the Department consider;

- such other information or documents as the Department may reasonably request from the member firm related to the evaluation; and
- any other information the Department deems necessary or appropriate to evaluate the matter.

To the extent a member firm seeks to claim undue financial hardship, it is the member firm's burden to support that with documents and information.

Department Decision and Notice (Rule 4111(e)); No Stays

Rule 4111(e) requires that, after the Consultation, the Department render a Department decision. Under Rule 4111(e)(1), there are three paths that decision might take:

- If the Department determines that the member firm has rebutted the presumption that it should be designated as a Restricted Firm, the Department's decision will state that the member firm will not be designated that year as a Restricted Firm.
- If the Department determines that the member firm has not rebutted the presumption that it should be designated as a Restricted Firm or the presumption that it must be subject to the maximum Restricted Deposit Requirement, the Department's decision will:
  - designate the member firm as a Restricted Firm; and
  - require the member firm to promptly establish a Restricted Deposit Account and deposit in that account the maximum Restricted Deposit Requirement; and
  - require the member firm to implement and maintain specified conditions or restrictions, as necessary or appropriate, on the operations and activities of the member firm and its associated persons that relate to, and are designed to address the concerns indicated by, the Preliminary Criteria for Identification and protect investors and the public interest.
- If the Department determines that the member firm has not rebutted the presumption that it should be designated as a Restricted Firm but has rebutted the presumption that it shall be subject to the maximum Restricted Deposit Requirement, the Department's decision will:
  - designate the member firm as a Restricted Firm;
  - impose no Restricted Deposit Requirement on the member firm, or will require the member firm to promptly establish a Restricted Deposit Account, deposit in that account a Restricted Deposit Requirement in such dollar amount less than the maximum Restricted Deposit Requirement as the Department deems necessary or appropriate; and

- require the member firm to implement and maintain specified conditions or restrictions, as necessary or appropriate, on the operations and activities of the member firm and its associated persons that relate to, and are designed to address the concerns indicated by, the Preliminary Criteria for Identification and protect investors and the public interest.[32]

Rule 4111(e)(2) provides that the Department will issue a written notice of its decision to the member firm, pursuant to new Rule 9561 and no later than 30 days from the latest letter provided to the member firm under Rule 4111(d)(2), that states the obligations to be imposed on the member firm, if any, and the ability of the member firm to request a hearing with the Office of Hearing Officers in an expedited proceeding.[33]

Rule 4111(e)(2) provides that a request for a hearing will not stay the effectiveness of the Department's decision. However, upon requesting a hearing of a Department decision that imposes a Restricted Deposit Requirement, the member firm will only be required to deposit in a Restricted Deposit Account the lesser of 25 percent of its Restricted Deposit Requirement or 25 percent of its average excess net capital during the prior calendar year, until the Office of Hearing Officers or the National Adjudicatory Council (NAC) issues its final written decision in the expedited proceeding. This has one exception: A member firm that is re-designated as a Restricted Firm and is already subject to a previously imposed Restricted Deposit Requirement will be required to keep in the Restricted Deposit Account the assets then on deposit therein until the Office of Hearing Officers or the NAC issues a written decision in the expedited proceeding.

Continuation or Termination of Restricted Firm Obligations (Rule 4111(f))

Rule 4111(f) contains provisions that set forth how any obligations that were imposed during the Rule 4111 process in one year are continued or terminated in that same year and in subsequent years.

Rule 4111(f)(1), titled "Currently Designated Restricted Firms," establishes constraints on a member firm's ability to seek to modify or terminate, directly or indirectly, any obligations imposed pursuant to Rule 4111. Because Rule 4111 will entail annual reviews by the Department to determine whether a member firm is a Restricted Firm that should be subject to obligations, a Restricted Firm will be able to seek each year to terminate or modify any obligations that continue to be imposed. For this reason, Rule 4111 does not authorize a Restricted Firm to seek, outside of the Consultation process and any ensuing expedited proceedings after a Department decision, a separate interim termination or modification of any obligations imposed. Rather, Rule 4111(f)(1) provides that a currently designated Restricted Firm will not be permitted to withdraw all or any portion of its Restricted Deposit Requirement, or seek to terminate or modify any deposit requirement, conditions or restrictions that have been imposed on it, without the prior written consent of the Department. Rule 4111(f)(1) also provides that there shall be a presumption that the Department shall deny an application by a currently designated Restricted Firm to withdraw all or any portion of its Restricted Deposit Requirement.

Rule 4111(f)(2), titled "Re-Designation as a Restricted Firm," addresses the scenario when the Department determines in one year that a member firm is a Restricted Firm, and in the following year determines that the member firm still meets the Preliminary Criteria for Identification. In that instance, the Department will provide a written letter to the member firm stating that it shall be re-designated as a Restricted Firm, and that the obligations previously imposed on the member firm shall remain effective and unchanged, unless either the member firm or the Department requests a Consultation in writing within seven days of the Department's letter. If a Consultation is requested, the obligations previously imposed will continue unchanged unless and until the Department modifies or terminates them after the Consultation. In addition, in the Consultation process, a presumption will apply that any previously imposed Restricted Deposit Requirement, conditions or restrictions will remain effective and unchanged absent a showing by the party seeking changes that they are no longer necessary or appropriate for the protection of investors or in the public interest. If a Consultation is not requested, the firm shall be subject to Rule 4111(f)(1) (the provision that governs "currently designated Restricted Firms").

Rule 4111(f)(2) further provides that when FINRA re-designates a member as a Restricted Firm and the member is subject to a Restricted Deposit Requirement, the member shall promptly after such re-designation (or, in the case where a hearing is requested pursuant to Rule 9561, promptly after the Office of Hearing Officers or the NAC issues a written decision under Rule 9559) deposit additional cash or qualified securities in the member's Restricted Deposit Account to the extent necessary to cause the aggregate value of the cash and qualified securities in the member's Restricted Deposit Account to be not less than its re-designated Restricted Deposit Requirement.

Rule 4111(f)(3), titled "Previously Designated Restricted Firms," addresses the scenario where the Department determines in one year that a member firm is a Restricted Firm, but in the following year(s) determines that the member firm or former member firm[34] either does not meet the Preliminary Criteria for Identification or should not be designated as a Restricted Firm. In that case, the member firm or former member firm will no longer be subject to any obligations previously imposed under Rule 4111.

There is one exception: A former Restricted Firm will not be permitted to withdraw any portion of its Restricted Deposit Requirement without submitting an application and obtaining the Department's prior written consent for the withdrawal. Such an application will be required to include, among other things set forth in Rule 4111(f)(3)(A), evidence as to whether the firm, its Associated Persons, or the former member firm have Covered Pending Arbitration Claims or any unpaid arbitration awards outstanding. The Department will determine whether to authorize a withdrawal, in part or in whole, and several presumptions will apply. Rule 4111(f)(3)(B)(i) establishes a presumption that the Department shall approve an application for withdrawal if the member firm, its Associated Persons, or the former member firm have no Covered Pending Arbitration Claims or unpaid arbitration awards. Rule 4111(f)(3)(B)(ii) establishes presumptions that the Department

shall: (a) Deny an application for withdrawal if the member firm, the member firm's Associated Persons who are owners or control persons, or the former member have any Covered Pending Arbitration Claims or unpaid arbitration awards, or if the member's Associated Persons have any Covered Pending Arbitration Claims or unpaid arbitration awards relating to arbitrations that involved conduct or alleged conduct that occurred while associated with the member; but (b) approve an application by a former member for withdrawal if the former member commits in the manner specified by the Department to use the amount it seeks to withdraw from its Restricted Deposit to pay the former member's specified unpaid arbitration awards. The Department will be required to issue, pursuant to Rule 9561, a notice of its decision on an application to withdraw from the Restricted Deposit Account within 30 days from the date the application is received by the Department.[35]

Restricted Deposit Account (Rule 4111(i)(14))

If a Department decision requires a member firm to establish a Restricted Deposit Account, Rule 4111(i)(14) will govern this account. The underlying policy for the account requirements is that, to make a deposit requirement effective in creating appropriate incentives to member firms that pose higher risks to change their behavior, the member firm must be restricted from withdrawing any of the required deposit amount, even if it terminates its FINRA membership.

Rule 4111(i)(14) requires that the Restricted Deposit Account be established in the name of the member firm, at a bank or the member firm's clearing firm. The account must be subject to an agreement in which the bank or the clearing firm agrees:

- not to permit withdrawals from the account absent FINRA's prior written consent;
- to keep the account separate from any other accounts maintained by the member firm with the bank or clearing firm;
- that the cash or qualified securities on deposit will not be used directly or indirectly as security for a loan to the member firm by the bank or the clearing firm, and will not be subject to any set-off, right, charge, security interest, lien, or claim of any kind in favor of the bank, clearing firm or any person claiming through the bank or clearing firm;
- that if the member firm becomes a former member, the assets deposited in the Restricted Deposit Account to satisfy the Restricted Deposit Requirement shall be kept in the Restricted Deposit Account, and withdrawals will not be permitted without FINRA's prior written consent;
- that FINRA is a third-party beneficiary to the agreement; and
- that the agreement may not be amended without FINRA's prior written consent.

In addition, the Restricted Deposit Account may not be subject to any right, charge, security interest, lien, or claim of any kind granted by the member.[36]

Books and Records (Rule 4111(g))

Rule 4111(g) establishes requirements to maintain books and records that evidence the member firm's compliance with Rule 4111 and any Restricted Deposit Requirement or other conditions or restrictions imposed under that rule. In addition, the books and records provision specifically requires a member firm subject to a Restricted Deposit Requirement to provide to the Department, upon its request, records that demonstrate the member firm's compliance with that requirement.

Notice of Failure to Comply (Rule 4111(h))

Under Rule 4111(h), FINRA will be authorized to issue a notice pursuant to Rule 9561(b) directing a member firm that is not in compliance with its Restricted Deposit Requirement, or with any conditions or restrictions imposed under Rule 4111, to suspend all or a portion of its business.

Net Capital Treatment of the Deposits in the Restricted Deposit Account (Rule 4111.01)

Supplementary Material .01 provides that, because of the restrictions on withdrawals from a Restricted Deposit Account, deposits in such an account cannot be readily converted to cash and therefore shall be deducted in determining the member's net capital under Exchange Act Rule 15c3-1[37] and FINRA Rule 4110.

Compliance With Continuing Membership Application Rule (Rule 4111.02—Compliance with Rule 1017)

Supplementary Material .02 provides that nothing in Rule 4111 shall be construed as altering a member firm's obligations under Rule 1017 (Application for Approval of Change in Ownership, Control, or Business Operations). A member firm subject to Rule 4111 will need to continue complying with the requirements of Rule 1017 and submit continuing membership applications as necessary.

Examples of Conditions and Restrictions (Rule 4111.03)

Supplementary Material .03 provides a non-exhaustive list of examples of conditions and restrictions that the Department could impose on Restricted Firms. This non-exhaustive list is intended to provide clarity about the Department's authority to impose conditions and restrictions without restricting the Department's flexibility to react and respond to different sources of risk.

New Rule 9561 and Amendments to Rule 9559

Rule 9561 establishes a new expedited proceeding that will: (1) allow member firms to request a prompt review of the Department's determinations under Rule 4111 and challenge any of the "Rule 4111 Requirements"[38] imposed, including any Restricted Deposit Requirements; and (2) address a member firm's failure to comply with any requirements imposed under Rule 4111.

Notices Under Rule 4111 (Rule 9561(a))

Rule 9561(a) establishes an expedited proceeding for the Department's determinations under Rule 4111 to designate a member firm as a Restricted Firm and impose obligations on the member; and to deny a member's request to access all or part of its Restricted Deposit Requirement. Rule 9561(a) requires the Department to serve a notice that provides its determination and the specific grounds and factual basis for the Department's action; states when the action will take effect; informs the member firm that it may file, pursuant to Rule 9559, a request for a hearing in an expedited proceeding within seven days after service of the notice; and explains the Hearing Officer's authority.[39] The rule also provides that, if a member firm does not request a hearing, the notice of the Department's determination will constitute final FINRA action.[40]

In general, a request for a hearing will not stay any of the Rule 4111 Requirements imposed in the Department's decision, which would be immediately effective.[41] There would be one exception: When a member firm requests review of a Department determination under Rule 4111 that imposes a Restricted Deposit Requirement on the member for the first time, the member firm will be required to deposit, while the expedited proceeding is pending, the lesser of 25 percent of its Restricted Deposit Requirement or 25 percent of its average excess net capital over the prior year.[42] As explained above, however, this exception would not be available for a member firm that has been re-designated as a Restricted Firm, and is already subject to a previously imposed Restricted Deposit Requirement; in that instance, the firm would need to keep the assets on deposit in the Restricted Deposit Account until the Office of Hearing Officers or NAC issues a written decision.[43]

Notice for Failure to Comply with the Rule 4111 Requirements (Rule 9561(b))

Rule 9561(b) authorizes the Department, after receiving authorization from FINRA's chief executive officer (CEO), or such other executive officer as the CEO may designate, to serve a notice stating that the member firm's failure to comply with the Rule 4111 Requirements, within seven days of service of the notice, will result in a suspension or cancellation of membership.[44] The rule requires that the notice identify the requirements with which the member firm is alleged to have not complied; include a statement of facts specifying the alleged failure; state when the action will take effect; explain what the member firm must do to avoid the suspension or cancellation; inform the member firm that it may file,

pursuant to Rule 9559, a request for a hearing in an expedited proceeding within seven days after service of the notice; and explain the Hearing Officer's authority.[45] The rule provides that the suspension or cancellation referenced in a notice shall become effective seven days after service of the notice unless stayed by a request for a hearing.[46] The rule also provides that a member firm may file a request seeking termination of a suspension imposed pursuant to the rule, on the ground of full compliance with the notice or decision, and authorizes the head of the Department to grant relief for good cause shown.[47]

Hearings (Amendments to Rule 9559)

If a member firm requests a hearing under Rule 9561, the hearing will be subject to Rule 9559. Several amendments to Rule 9559 have been approved that are specific to hearings requested pursuant to Rule 9561. These include, among others, amendments to Rule 9559(d) and (n) to establish the authority of the Hearing Officer; amendments to Rule 9559(f) to set out timing requirements for hearings conducted under Rule 9561(a) and (b); and amendments to Rule 9559(p)(6) to account for the obligations that may be imposed under Rule 4111 within the content requirements of any decision issued by a Hearing Officer under the Rule 9550 Series.[48]

Endnotes

1. *See* Securities Exchange Act Release No. 92525 (July 30, 2021), 86 FR 42925 (August 5, 2021) (Order Approving File No. SR-FINRA-2020-041, as Modified by Amendment Nos. 1 and 2) (Approval Order).
2. *See* Securities Exchange Act Release No. 83181 (May 7, 2018), 83 FR 22107 (May 11, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2018-018).
3. *See Regulatory Notice 18-16* (April 2018).
4. *See Regulatory Notice 21-09* (March 2021).
5. The term "Covered Pending Arbitration Claim" is defined in Rule 4111(i)(2) to mean, for purposes of Rule 4111, an investment-related, consumer initiated claim filed against the member or its associated persons in any arbitration forum that is unresolved; and whose claim amount (individually or, if there is more than one claim, in the aggregate) exceeds the member's excess net capital. The claim amount includes claimed compensatory loss amounts only, not requests for pain and suffering, punitive damages or attorney's fees, and shall be the maximum amount for which the member or associated person, as applicable, is potentially liable regardless of whether the claim was brought against additional persons or the associated person reasonably expects to be indemnified, share liability or otherwise lawfully avoid being held responsible for all or part of such maximum amount. This term conforms, in relevant part, to the definition of Covered Pending Arbitration Claim in Rule 1011(c).
6. For purposes of this *Regulatory Notice*, "unpaid arbitration awards" also includes unpaid settlements related to arbitrations.
7. "Restricted Deposit Requirement" is defined in Rule 4111(i)(15) and is further described below.
8. FINRA also has recently amended its Membership Application Program rules to create further incentives for the timely payment of arbitration awards by preventing an individual from switching firms, or a firm from using asset transfers or similar transactions, to avoid payment of arbitration awards. *See Regulatory Notice 20-15* (May 2020).
9. "Restricted Deposit Account" is defined in Rule 4111(i)(14) and is further described below.
10. *See* Rule 4111(i)(10) (definition of "Preliminary Identification Metrics").
11. *See* Rule 4111(i)(9) (definition of "Preliminary Criteria for Identification").
12. *See* Rule 4111(i)(11) (definition of "Preliminary Identification Metrics Thresholds").
13. *See* Rule 4111(i)(4) (defining "Disclosure Event and Expelled Firm Association Categories").
14. *See* Rule 4111(i)(17) (defining "Uniform Registration Forms").
15. "Registered Person Adjudicated Events," defined in Rule 4111(i)(4)(A), means any one of the following events that are reportable on the registered person's Uniform Registration Forms: (i) A final investment-related, consumer-initiated customer arbitration award or civil judgment against the registered person in which the registered person was a named party, or was a "subject of" the customer arbitration award or civil judgment; (ii) a final investment-related, consumer-initiated customer arbitration settlement, civil litigation settlement or a settlement prior to a customer arbitration or civil litigation for a dollar amount at or above $15,000 in which the registered person was a named party or was a "subject of" the customer arbitration settlement, civil

litigation settlement or a settlement prior to a customer arbitration or civil litigation; (iii) a final investment-related civil judicial matter that resulted in a finding, sanction or order; (iv) a final regulatory action that resulted in a finding, sanction or order, and was brought by the SEC or Commodity Futures Trading Commission (CFTC), other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority or a self-regulatory organization; or (v) a criminal matter in which the registered person was convicted of or pled guilty or nolo contendere (no contest) in a domestic, foreign or military court to any felony or any reportable misdemeanor.

16. "Registered Person Pending Events," defined in Rule 4111(i)(4)(B), means any one of the following events associated with the registered person that are reportable on the registered person's Uniform Registration Forms: (i) A pending investment-related civil judicial matter; (ii) a pending investigation by a regulatory authority; (iii) a pending regulatory action that was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority or a self-regulatory organization; or (iv) a pending criminal charge associated with any felony or any reportable misdemeanor. Registered Person Pending Events does not include pending arbitrations, pending civil litigations or consumer-initiated complaints that are reportable on the registered person's Uniform Registration Forms.

17. "Registered Person Termination and Internal Review Events," defined in Rule 4111(i)(4)(C), means any one of the following events associated with the registered person at a previous member firm that are reportable on the registered person's Uniform Registration Forms: (i) A termination in which the registered person voluntarily resigned, was discharged or was permitted to resign from a previous member after allegations; or (ii) a pending or closed internal review by a previous member. Under this definition, the included termination and internal review disclosures concerning a person whom a member firm terminated will not impact that member firm's own Registered Person Termination and Internal Review Event Metric; rather, they will impact only the metrics of member firms that subsequently register the terminated individual.

18. "Member Firm Adjudicated Events," defined in Rule 4111(i)(4)(D), means any one of the following events that are reportable on the member firm's Uniform Registration Forms or based on customer arbitrations filed with FINRA's dispute resolution forum: (i) A final investment-related, consumer-initiated customer arbitration award in which the member was a named party; (ii) a final investment-related civil judicial matter that resulted in a finding, sanction or order; (iii) a final regulatory action that resulted in a finding, sanction or order, and was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority or a self-regulatory organization; or (iv) a criminal matter in which the member was convicted of or pled guilty or nolo contendere (no contest) in a domestic, foreign or military court to any felony or any reportable misdemeanor. As FINRA previously explained, Rule 4111(i)(4)(D)(i) is intended to capture all BrokerCheck disclosures of arbitration awards against firms. *See* FINRA Response to Comments, at p. 8, SR-FINRA-2020-041 (March 4, 2021), available at *https://www.finra.org/sites/default/files/2021-03/sr-finra-2020-041-response-to-comments.pdf*.

19. "Member Firm Pending Events," defined in Rule 4111(i)(4)(E), means any one of the following events that are reportable on the member firm's Uniform Registration Forms: (i) a pending investment-related civil judicial matter; (ii) a pending regulatory action that was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority or a self-regulatory organization; or (iii) a pending criminal charge associated with any felony or any reportable misdemeanor.

20. "Registered Persons Associated with Previously Expelled Firms," defined in Rule 4111(i)(4)(F), means any "Registered Person In-Scope" who was registered for at least one year with a previously expelled firm and whose registration with the previously expelled firm terminated during the "Evaluation Period" (*i.e.*, the prior five years from the "Evaluation Date," which is the annual date as of which the Department calculates the Preliminary Identification Metrics to determine if the member firm meets the Preliminary Criteria for Identification). *See* Rule 4111(i)(5), (6), and (13) (definitions of "Evaluation Date," "Evaluation Period," and "Registered Persons In-Scope").

21. *See* Rule 4111(i)(10)(A), (C) and (D); Rule 4111(i)(6) (definition of "Evaluation Period").

22. *See* Rule 4111(i)(10)(B), (C) and (E); Rule 4111(i)(6) (definition of "Evaluation Period").

23. *See* Rule 4111(i)(10)(A), (B) and (C); Rule 4111(i)(13) (definition of "Registered Persons In-Scope").

24. *See* Rule 4111(i)(12) (definition of "Registered Person and Member Firm Events").

25. *See* Rule 4111(i)(10)(A)-(E).

26. *See* Rule 4111(i)(10)(F).

27. The purpose of ensuring that a firm does not meet the Preliminary Criteria for Identification solely because of pending matters is because FINRA recognizes that pending matters include disclosure events that may remain unresolved or that may subsequently be dismissed or concluded with no adverse action.

28. *See* Rule 4111(b) and (i)(9)(A).

29. *See* Rule 4111(b) and (i)(9)(B).

30. The Department's consideration of claims and awards against the firm's Associated Persons would focus on claims and awards against Associated Persons who are owners or control persons and on claims and awards relating to arbitrations that involved conduct or alleged conduct that occurred while associated with the member firm. See Securities Exchange Act Release No. 90527 (November 27, 2020), 85 FR 78540, 78545 n.33 (December 4, 2020) (Notice of Filing of File No. SR-FINRA-2020-041) (Filing).

31. The term "maximum" is used to indicate that a firm's maximum Restricted Deposit Requirement will be the figure FINRA declares to the firm is the highest deposit requirement to which it may be subject during that year's Rule 4111 process. *See* Approval Order, 86 FR 42925, 42930 n.88.

32. A Restricted Deposit Requirement will require the member firm to promptly deposit in a Restricted Deposit Account cash or qualified securities with an aggregate value that is not less than the firm's Restricted Deposit Requirement, but will not require the firm to make additional deposits in order to maintain continuously the original value of the qualified securities in its Restricted Deposit Account, if such qualified securities have declined in value. Likewise, if the aggregate value of the assets deposited by a member firm to comply with its Restricted Deposit Requirement

increases above the firm's Restricted Deposit Requirement, that would not be a basis for the firm to request a withdrawal from its Restricted Deposit Account. *See* Partial Amendment No. 2, at p. 4, SR-FINRA-2020-041 (July 20, 2021) (Partial Amendment No. 2). As described below, there are additional requirements in Rule 4111(f)(2) that apply when FINRA re-designates a member firm as a Restricted Firm and the member is subject to a Restricted Deposit Requirement.

33. As FINRA has previously explained, FINRA plans to file with the SEC a proposed amendment to Rule 8312 (FINRA BrokerCheck Disclosure) to release on BrokerCheck information as to whether a particular member firm or former member firm is designated as a Restricted Firm pursuant to Rules 4111 and 9561. *See* FINRA Response to Comments, at p. 3, SR-FINRA-2020-041 (July 20, 2021), available at *https://www.finra.org/sites/default/files/2021-07/SR-FINRA-2020-041-response-to-comments.pdf*. In addition, in Rule 9561 expedited proceedings, FINRA shall release to the public a copy of, and information with respect to, any decision issued pursuant to Rule 9559 that constitutes final FINRA action. *See* Rule 8313(a)(3).

34. *See* Rule 4111(i)(7) (definition of "Former Member").

35. *See* Rule 4111(f)(3)(B).

36. As FINRA has explained, funds or securities on deposit in a Restricted Firm's Restricted Deposit Account are not held with respect to any particular claim, or class of claimants, against the Restricted Firm. In the event of a liquidation of a Restricted Firm, funds or securities on deposit in the Restricted Deposit Account would be additional financial resources available to satisfy claims against the Restricted Firm. *See* Partial Amendment No. 2, at 4 n.6.

37. *See* 17 CFR 240.15c3-1.

38. *See* Rule 9561(a)(1) (defining the "Rule 4111 Requirements" to mean the requirements, conditions, or restrictions imposed by a Department determination under Rule 4111).

39. *See* Rule 9561(a)(1), (2), (3) and (5).

40. *See* Rule 9561(a)(6).

41. *See* Rule 9561(a)(4).

42. *See* Rule 9561(a)(4).

43. *See* Rule 4111(e)(2).

44. *See* Rule 9561(b)(1), (2).

45. *See* Rule 9561(b)(3) and (5).

46. *See* Rule 9561(b)(4) and (6).

47. *See* Rule 9561(b)(7).

48. Amendments also have been approved to Rule 9559(b) (computation of time), (c) (stays), (e) (consolidation of severance of proceedings), (g) (notice of hearing), (h) (transmission of documents) and (o) (timing of decision). Additionally, in expedited proceedings pursuant to Rule 9561(a) to review a Department determination under Rule 4111, a member firm may sometimes seek to demonstrate that the Department included incorrectly disclosure events when calculating whether the member firm meets the Preliminary Criteria for Identification. When the member firm does so, however, it will not be permitted to collaterally attack the underlying merits of those final actions. *See* Filing, 85 FR 78540, 78550 & n.45; see also Approval Order, 86 FR 42925, 42932 n.115.

Attachment A

New and Amended Rule Text

New language is underlined; deletions are in brackets.

* * * * *

FINRA Rules

* * * * *

4000. FINANCIAL AND OPERATIONAL RULES

* * * * *

4111. Restricted Firm Obligations

(a) General

A member designated as a Restricted Firm shall be required, except as provided in paragraphs (e) and (f) of this Rule, to establish a Restricted Deposit Account and deposit in that account cash or qualified securities with an aggregate value that is not less than the member's Restricted Deposit Requirement, and shall be subject to such conditions or restrictions on the member's operations as determined by the Department to be necessary or appropriate for the protection of investors and in the public interest.

(b) Annual Calculation by FINRA of Preliminary Criteria for Identification

For each member, the Department will compute annually (on a calendar-year basis) the Preliminary Identification Metrics to determine if the member meets the Preliminary Criteria for Identification.

(c) Initial Department Evaluation and One-Time Staff Reduction

(1) Initial Department Evaluation

If the member is deemed to meet the Preliminary Criteria for Identification, the Department shall conduct an internal evaluation to determine whether (A) the member does not warrant further review under this Rule because the Department has information to conclude that the computation of the member's Preliminary Identification Metrics included disclosure events (and other conditions) that should not have been included because they are not consistent with the purpose of the Preliminary Criteria for Identification and are not reflective of a firm posing

a high degree of risk. The Department shall also consider whether the member has addressed the concerns signaled by the disclosure events or conditions or altered its business operations such that the Preliminary Criteria for Identification calculation no longer reflects the member's current risk profile, or (B) except as provided in paragraph (c)(2) of this Rule, the member should proceed to a Consultation.

(2) One-Time Staff Reduction

If the Department determines that the member meets the Preliminary Criteria for Identification and such member has met such criteria for the first time, such member may reduce its staffing levels to no longer meet the Preliminary Criteria for Identification within 30 business days after being informed by the Department. The member shall provide evidence of the staff reduction to the Department identifying the terminated individuals. Once the member has reduced staffing levels to no longer meet the Preliminary Criteria for Identification, it shall not rehire in any capacity a person terminated to accomplish the staff reduction for a period of one year.

(3) Close-Out Review

If the Department determines that the member no longer warrants further review in accordance with paragraph (c)(1)(A) or (c)(2) of this Rule, the Department shall close out the review of the member for such year.

(d) Consultation

(1) General

If the Department determines that the member meets the Preliminary Criteria for Identification and should proceed to a Consultation, the Department shall conduct the Consultation to allow the member to demonstrate why it does not meet the Preliminary Criteria for Identification and should not be designated as a Restricted Firm. If the member is designated as a Restricted Firm, the Department may require it to be subject to a Restricted Deposit Requirement or to such conditions or restrictions as the Department in its discretion shall deem necessary or appropriate for the protection of investors or in the public interest, or both. The member bears the burden of demonstrating that it should not be designated as a Restricted Firm and should not be subject to the maximum Restricted Deposit Requirement.

(A) A member may overcome the presumption that it should be designated as a Restricted Firm by clearly demonstrating that the Department's calculation that the member meets the Preliminary Criteria for Identification included events in the Disclosure Event and Expelled Firm Association Categories that should not have been included because for example, they are duplicative, involving the same customer and the same matter, or are not sales practice related; and

(B) A member may overcome the presumption that it should be subject to the maximum Restricted Deposit Requirement by clearly demonstrating to the Department that the member would face significant undue financial hardship if it were subject to the maximum Restricted Deposit Requirement and that a lesser deposit requirement would satisfy the objectives of this Rule and be consistent with the protection of investors and the public interest; or that conditions and restrictions on the operations and activities of the member and its associated persons would address the concerns indicated by the Preliminary Criteria for Identification and protect investors and the public interest.

(2) Scheduling Consultation

The Department shall provide a written letter to each member it determines should proceed to a Consultation or that will proceed to a Consultation pursuant to paragraph (f)(2) of this Rule at least seven days prior to the Consultation, of the date, time and place of the Consultation and shall coordinate with the member to schedule further meetings as necessary. A Consultation shall begin at the time scheduled, unless the Department, for good cause shown by the member, provides a written letter that postpones the commencement of the Consultation. Postponements shall not exceed 30 days unless the member establishes the reasons a longer postponement is necessary.

(3) Consultation Process

In conducting its evaluation of whether a member should be designated as a Restricted Firm and subject to a Restricted Deposit Requirement, the Department shall consider:

(A) information provided by the member during any meetings as part of the Consultation;

(B) relevant information or documents, if any, submitted by the member, in the manner and form prescribed by the Department, as shall be necessary or appropriate for the Department to review the computation of the Preliminary Criteria for Identification;

(C) a plan, if any, submitted by the member, in the manner and form prescribed by the Department, proposing in detail the specific conditions or restrictions that the member seeks to have the Department consider;

(D) such other information or documents as the Department may reasonably request in its discretion from the member related to the evaluation; and

(E) any other information the Department deems necessary or appropriate to evaluate the matter.

(e) Department Decision and Notice

(1) Department Decision

Following the Consultation, but no later than 30 days from the date of the latest letter provided to the member under paragraph (d)(2) of this Rule, the Department shall render a Department Decision as follows:

(A) If the Department determines that the member has rebutted the presumption set forth in paragraph (d)(1)(A) of this Rule that it should be designated as a Restricted Firm, the Department's decision shall state that the firm shall not be designated as a Restricted Firm.

(B) If the Department determines that the member has failed to rebut the presumption set forth in paragraphs (d)(1)(A) and (d)(1)(B) of this Rule that it should be designated as a Restricted Firm that shall be subject to the maximum Restricted Deposit Requirement, the Department's decision shall designate the member as a Restricted Firm and require the member to: (i) promptly establish a Restricted Deposit Account and deposit in that account the maximum Restricted Deposit Requirement; and (ii) implement and maintain specified conditions or restrictions, as the Department deems necessary or appropriate, on the operations and activities of the member and its associated persons to address the concerns indicated by the Preliminary Criteria for Identification and protect investors and the public interest.

(C) If the Department determines that the member has failed to rebut the presumption in paragraph (d)(1)(A) of this Rule that it should be designated as a Restricted Firm but that it has rebutted the presumption in paragraph (d)(1)(B) of this Rule that it shall be subject to the maximum Restricted Deposit Requirement, the Department shall designate the member as a Restricted Firm and shall: (i) impose no Restricted Deposit Requirement on the member or require the member to promptly establish a Restricted Deposit Account and deposit in that account a Restricted Deposit Requirement in such dollar amount less than the maximum Restricted Deposit Requirement as the Department deems necessary or appropriate; and (ii) require the member to implement and maintain specified conditions or restrictions, as the Department deems necessary or appropriate, on the operations and activities of the member and its associated persons to address the concerns indicated by the Preliminary Criteria for Identification and protect investors and the public interest.

(2) Notice of Department Decision, No Stays

No later than 30 days following the latest letter provided to the member under paragraph (d)(2) of this Rule, the Department shall issue a notice of the Department's decision pursuant to Rule 9561(a) that states the obligations to be imposed on the member, if any, under this Rule 4111 and the ability of the member under Rule 9561 to request a hearing with the Office of Hearing Officers. A timely request for a hearing shall not stay the effectiveness of the notice issued under Rule 9561(a), except that for a notice under Rule 9561(a) a member subject to a Restricted Deposit Requirement shall be required to deposit in a Restricted Deposit Account the lesser of 25 percent of its Restricted Deposit Requirement or 25 percent of its average excess net capital during the prior calendar year, until the Office of Hearing Officers or the NAC issues a written decision under Rule 9559; provided, however, that a member that has been re-designated as a Restricted Firm as set forth in paragraph (f)(2) of this Rule and is already subject to a previously imposed Restricted Deposit Requirement shall be required to keep in the Restricted Deposit Account the assets then on deposit therein until the Office of Hearing Officers or NAC issues a written decision under Rule 9559.

(f) Continuation or Termination of Restricted Firm Obligations

(1) Currently Designated Restricted Firms

A member or Former Member that is currently designated as a Restricted Firm subject to the requirements of this Rule shall not be permitted to withdraw all or any portion of its Restricted Deposit Requirement, or seek to terminate or modify any deposit requirement, conditions, or restrictions that have been imposed pursuant to this Rule, without the prior written consent of the Department. There shall be a presumption that the Department shall deny an application by a member or Former Member that is currently designated as a Restricted Firm to withdraw all or any portion of its Restricted Deposit Requirement. An application under this paragraph for a withdrawal from a Restricted Deposit Requirement shall comply with the content requirements in paragraph (f)(3)(A)(i) through (iv) of this Rule.

(2) Re-Designation as a Restricted Firm

Where a member has been designated as a Restricted Firm in one year and is determined to meet the Preliminary Criteria for Identification the following year in accordance with paragraph (b) of this Rule, the Department shall provide a written letter to the member stating that it shall be re-designated as a Restricted Firm, and that the obligations previously imposed on the member in accordance with this Rule shall remain effective and unchanged, unless either the member or the Department requests a Consultation in writing within seven days of the date of the letter, in which case the obligations previously imposed shall remain effective and unchanged unless and until the Department modifies or terminates them after the Consultation. If a Consultation is conducted, there shall be a presumption that the Restricted Deposit Requirement and conditions or restrictions, if any, previously imposed on the member shall remain effective and unchanged absent a showing by the party seeking changes that the previously imposed obligations are no longer necessary or appropriate for the protection of investors or in the public interest. If a Consultation is not timely requested, the member shall be subject to paragraph (f)(1) of this Rule. When FINRA re-designates a member as a Restricted Firm and the member is subject to a Restricted Deposit Requirement, the member shall promptly after such re-designation (or, in the case where a hearing is requested pursuant to Rule 9561, promptly after the Office of Hearing Officers or the NAC issues a written decision under Rule 9559) deposit additional cash or qualified securities in the member's Restricted Deposit Account to the extent necessary to

cause the aggregate value of the cash and qualified securities in the member's Restricted Deposit Account to be not less than its re-designated Restricted Deposit Requirement.

(3) Previously Designated Restricted Firms

(A) A member or Former Member that is a Restricted Firm in one year, but does not meet the Preliminary Criteria for Identification or is not designated as a Restricted Firm the following year(s), shall no longer be subject to any deposit requirement, conditions, or restrictions previously imposed on it under this Rule; provided, however, the member or Former Member shall not be permitted to withdraw any portion of its Restricted Deposit Requirement without submitting an application and obtaining the prior written consent of the Department. Such application shall:

(i) be made in such form and manner as FINRA may prescribe;

(ii) be accompanied by a copy of a current account statement for the member or Former Member's Restricted Deposit Account;

(iii) include a certification by the member's or Former Member's chief executive officer (or equivalent officer) stating the member's or Former Member's Restricted Deposit Requirement; the value of the cash or qualified securities on deposit in the member's or Former Member's Restricted Deposit Account; the value of cash or qualified securities on deposit in the member's or Former Member's Restricted Deposit Account that the member or Former Member is seeking the Department's consent to withdraw; and

(iv) include evidence that there are no "Covered Pending Arbitration Claims," unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding against the member, the member's Associated Persons or the Former Member, or if there are any "Covered Pending Arbitration Claims," unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding, provide a detailed description of such.

(B) After such review and investigation as it considers necessary or appropriate, the Department shall determine whether to authorize a withdrawal, in part or whole, of cash or qualified securities from the member's or Former Member's Restricted Deposit Account. There shall be presumptions

that the Department shall: (i) approve an application for withdrawal if the member, the member's Associated Persons, or the Former Member have no "Covered Pending Arbitration Claims," unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding; and (ii) (a) deny an application for withdrawal if the member, the member's Associated Persons who are owners or control persons, or the Former Member have any "Covered Pending Arbitration Claims," unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding, or if the member's Associated Persons have any "Covered Pending Arbitration Claims," unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding that involved conduct or alleged conduct that occurred while associated with the member; but (b) approve an application by a Former Member for withdrawal if the Former Member commits in the manner specified by the Department to use the amount it seeks to withdraw from its Restricted Deposit to pay the Former Member's specified unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding. Within 30 days from the date the application is received by the Department, the Department shall issue a notice of the Department's decision pursuant to Rule 9561(a).

(g) Books and Records

Each member shall maintain records evidencing the member's compliance with this Rule and any Restricted Deposit Requirement or conditions or restrictions imposed in accordance with this Rule, including without limitation, records relating to the calculation of the Preliminary Criteria for Identification, Consultation, the Restricted Deposit Account, conditions or restrictions imposed, and agreements with bank(s) or clearing firm(s), for a period of six years from the date the member is no longer subject to the requirements of this Rule. In addition, a firm that is subject to a Restricted Deposit Requirement shall provide to the Department, upon its request, records, agreements and account statements that demonstrate the firm's compliance with the Restricted Deposit Requirement.

(h) Notice of Failure to Comply

FINRA may issue a notice pursuant to Rule 9561(b) directing a member that is not in compliance with the Restricted Deposit Requirement or the conditions or restrictions imposed by this Rule to suspend all or a portion of its business.

(i) Definitions

For purposes of this Rule, the following terms shall have the following meanings:

(1) The term "Consultation" means one or more meetings or consultations between the Department and a member that meets the Preliminary Criteria for Identification.

(2) The term "Covered Pending Arbitration Claim," for purposes of this Rule 4111, means an investment-related, consumer initiated claim filed against the member or its Associated Persons in any arbitration forum that is unresolved; and whose claim amount (individually or, if there is more than one claim, in the aggregate) exceeds the member's excess net capital. For purposes of this definition, the claim amount includes claimed compensatory loss amounts only, not requests for pain and suffering, punitive damages or attorney's fees, and shall be the maximum amount for which the member or Associated Person, as applicable, is potentially liable regardless of whether the claim was brought against additional persons or the Associated Person reasonably expects to be indemnified, share liability or otherwise lawfully avoid being held responsible for all or part of such maximum amount.

(3) The term "Department" means FINRA's Department of Member Regulation.

(4) The term "Disclosure Event and Expelled Firm Association Categories" means the following categories of disclosure events and other information:

(A) "Registered Person Adjudicated Events" means any one of the following events that are reportable on the registered person's Uniform Registration Forms:

(i) a final investment-related, consumer-initiated customer arbitration award or civil judgment against the registered person in which the registered person was a named party or was a "subject of" the customer arbitration award or civil judgment;

(ii) a final investment-related, consumer-initiated customer arbitration settlement, civil litigation settlement or a settlement prior to a customer arbitration or civil litigation for a dollar amount at or above $15,000 in which the registered person was a named party or was a "subject of" the customer arbitration settlement, civil litigation settlement or a settlement prior to a customer arbitration or civil litigation;

(iii) a final investment-related civil judicial matter that resulted in a finding, sanction or order;

(iv) a final regulatory action that resulted in a finding, sanction or order, and was brought by the SEC or Commodity Futures Trading Commission (CFTC), other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization; or

(v) a criminal matter in which the registered person was convicted of or pled guilty or nolo contendere (no contest) in a domestic, foreign, or military court to any felony or any reportable misdemeanor.

(B) "Registered Person Pending Events" means any one of the following events associated with the registered person that are reportable on the registered person's Uniform Registration Forms:

(i) a pending investment-related civil judicial matter;

(ii) a pending investigation by a regulatory authority;

(iii) a pending regulatory action that was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization; or

(iv) a pending criminal charge associated with any felony or any reportable misdemeanor.

(C) "Registered Person Termination and Internal Review Events" means any one of the following events associated with the registered person at a previous member that are reportable on the registered person's Uniform Registration Forms:

(i) a termination in which the registered person voluntarily resigned, was discharged or was permitted to resign from a previous member after allegations; or

(ii) a pending or closed internal review by a previous member.

(D) "Member Firm Adjudicated Events" means any one of the following events that are reportable on the member's Uniform Registration Forms, or are based on customer arbitrations filed with FINRA's dispute resolution forum:

(i) a final investment-related, consumer-initiated customer arbitration award in which the member was a named party;

(ii) a final investment-related civil judicial matter that resulted in a finding, sanction or order;

(iii) a final regulatory action that resulted in a finding, sanction or order, and was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization; or

(iv) a criminal matter in which the member was convicted of or pled guilty or nolo contendere (no contest) in a domestic, foreign, or military court to any felony or any reportable misdemeanor.

(E) "Member Firm Pending Events" means any one of the following events that are reportable on the member's Uniform Registration Forms:

(i) a pending investment-related civil judicial matter;

(ii) a pending regulatory action that was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization; or

(iii) a pending criminal charge associated with any felony or any reportable misdemeanor.

(F) "Registered Persons Associated with Previously Expelled Firms" means any Registered Person In-Scope who was registered for at least one year with a previously expelled firm and whose registration with the previously expelled firm terminated during the Evaluation Period.

(5) The term "Evaluation Date" means the date, each calendar year, as of which the Department calculates the Preliminary Identification Metrics to determine if the member meets the Preliminary Criteria for Identification.

(6) The term "Evaluation Period" means the prior five years from the Evaluation Date, provided that for the Registered Person Pending Events and Member Firm Pending Events categories and pending internal reviews in the Registered Person Termination and Internal Review Events category, it would correspond to the Evaluation Date (and include all events that are pending as of the Evaluation Date).

(7) The term "Former Member" means an entity that has withdrawn or resigned its FINRA membership, or that has had its membership cancelled or revoked.

(8) The term "qualified security" has the meaning given it in SEA Rule 15c3-3(a)(6).

(9) The term "Preliminary Criteria for Identification" means meeting the following conditions:

(A) Two or more of the member's Preliminary Identification Metrics are equal to or more than the corresponding Preliminary Identification Metrics Thresholds, and at least one of these metrics is among the following metrics:

(i) Registered Person Adjudicated Event Metric;

(ii) Member Firm Adjudicated Event Metric; and

(iii) Expelled Firm Association Metric; and

(B) The member has two or more Registered Person and Member Firm Events during the Evaluation Period.

(10) The term "Preliminary Identification Metrics" means the following six metrics that are based on the number of disclosure events (defined above) per Registered Persons In-Scope or percent of Registered Persons In-Scope associated with previously expelled firms:

(A) "Registered Person Adjudicated Event Metric" would be computed as the sum of Registered Person Adjudicated Events that reached a resolution during the Evaluation Period, across all Registered Persons In-Scope and divided by the number of Registered Persons In-Scope.

(B) "Registered Person Pending Event Metric" would be computed as the sum of Registered Person Pending Events as of the Evaluation Date, across all Registered Persons In-Scope and divided by the number of Registered Persons In-Scope.

(C) "Registered Person Termination and Internal Review Event Metric" would be computed as the sum of Registered Person Termination and Internal Review Events that reached a resolution during the Evaluation Period and pending internal reviews by a previous member as of the Evaluation Date, across all Registered Persons In-Scope and divided by the number of Registered Persons In-Scope.

(D) "Member Firm Adjudicated Event Metric" would be computed as the sum of Member Firm Adjudicated Events that reached a resolution during the Evaluation Period, divided by the number of Registered Persons In-Scope.

(E) "Member Firm Pending Event Metric" would be computed as the sum of Member Firm Pending Events as of the Evaluation Date, divided by the number of Registered Persons In-Scope.

(F) "Expelled Firm Association Metric" would be computed as the sum of Registered Persons Associated with Previously Expelled Firms, divided by the number of Registered Persons In-Scope.

(11) The term "Preliminary Identification Metrics Thresholds" means the following thresholds corresponding to each of the six Preliminary Identification Metrics.

Firm Size Category	Number of Registered Persons In-Scope in Firm Size Category	Preliminary Identification Metrics Thresholds					
		Thresholds for Registered Person Event Metrics:			Thresholds for Member Firm Event Metrics:		Threshold for Expelled Firm Association Metric:
		Registered Person Adjudicated Event Metric	Registered Person Pending Event Metric	Registered Person Termination and Internal Review Event Metric	Member Firm Adjudicated Event Metric	Member Firm Pending Event Metric	Expelled Firm Association Metric
		(1)	(2)	(3)	(4)	(5)	(6)
1	1-4	0.50	0.20	0.10	0.75	0.25	0.30
2	5-9	0.30	0.20	0.10	0.30	0.10	0.25
3	10-19	0.20	0.10	0.10	0.30	0.05	0.20
4	20-50	0.20	0.10	0.10	0.20	0.02	0.15
5	51-150	0.20	0.05	0.10	0.15	0.01	0.03
6	151-499	0.15	0.05	0.10	0.10	0.01	0.01
7	500+	0.10	0.05	0.10	0.05	0.01	0.01

(12) The term "Registered Person and Member Firm Events" means the sum of the following categories of defined events during the Evaluation Period:

(A) Registered Person Adjudicated Events;

(B) Registered Person Pending Events;

(C) Registered Person Termination and Internal Review Events;

(D) Member Firm Adjudicated Events; and

(E) Member Firm Pending Events.

(13) The term "Registered Persons In-Scope" means all persons registered with the firm for one or more days within the one year prior to the Evaluation Date.

(14) The term "Restricted Deposit Account" means an account in the name of the member:

(A) at a bank (as defined in Section 3(a)(6) of the Exchange Act) or the member's clearing firm;

(B) subject to an agreement in which the bank or the member's clearing firm, as applicable, agrees:

(i) not to permit withdrawals (other than withdrawals of interest or the withdrawal of qualified securities or cash after and on the same day as the deposit of cash or qualified securities of equal value) from the Restricted Deposit Account without the prior written consent of FINRA;

(ii) to keep the account separate from any other accounts maintained by the member with the bank or clearing firm;

(iii) that the cash or securities on deposit in the account will at no time be used directly or indirectly as security for a loan to the member by the bank or clearing firm and will not be subject to any set-off, right, charge, security interest, lien, or claim of any kind in favor of the bank, clearing firm or any person claiming through the bank or clearing firm;

(iv) that if the member becomes a Former Member, the assets deposited in the Restricted Deposit Account to satisfy the Restricted Deposit Requirement shall be kept in the Restricted Deposit Account, and the bank or clearing firm will not permit withdrawals from the Restricted Deposit Account without the prior written consent of FINRA as set forth in paragraphs (f)(1) and (f)(3) of this Rule; and

(v) that FINRA is a third-party beneficiary to such agreement and that such agreement may not be amended without the prior written consent of FINRA; and

(C) not subject to any right, charge, security interest, lien or claim of any kind granted by the member.

(15) The term "Restricted Deposit Requirement" means one of the following amounts:

(A) the specific maximum Restricted Deposit Requirement for a member, determined by the Department taking into consideration the nature of the firm's operations and activities, revenues, commissions, assets, liabilities, expenses, net capital, the number of offices and registered persons, the nature of the disclosure events counted in the numeric thresholds, insurance coverage for customer arbitration awards or settlements, concerns raised during FINRA exams, and the amount of any of the firm's or its Associated Persons' Covered Pending Arbitration Claims, unpaid arbitration awards or unpaid settlements related to arbitrations. Based on a review of these factors, the Department would determine a maximum Restricted Deposit Requirement for the member that would be consistent with the objectives of this Rule, but would not significantly undermine the continued financial stability and operational capability of the firm as an ongoing enterprise over the next 12 months; or

(B) the amount, adjusted after the Consultation, determined by the Department; and

(C) with respect to a Former Member, the Restricted Deposit Requirement last calculated pursuant to paragraph (i)(15)(A) or (15)(B) of this Rule when the firm was a member.

(16) The term "Restricted Firm" means each member that is designated as such in accordance with paragraphs (e)(1)(B) and (e)(1)(C) of this Rule.

(17) The term "Uniform Registration Forms" means the Forms BD, U4, U5 and U6, as applicable.

• • • Supplementary Material: ----------

.01 Net Capital Treatment of the Deposits in the Restricted Deposit Account. Because of the restrictions on withdrawals from a Restricted Deposit Account, deposits in such an account cannot be readily converted into cash and therefore shall be deducted in determining the member's net capital under SEA Rule 15c3-1 and FINRA Rule 4110.

.02 Compliance with Rule 1017. Nothing in this Rule shall be construed as altering in any manner a member's obligations under Rule 1017.

.03 Examples of Conditions and Restrictions. For purposes of this Rule, the conditions or restrictions that the Department may impose include, but are not limited to, the following:

(a) limitations on business expansions, mergers, consolidations or changes in control;

(b) filing all advertising with FINRA's Department of Advertising Regulation;

(c) imposing requirements on establishing and supervising offices;

(d) requiring a compliance audit by a qualified, independent third party;

(e) limiting business lines or product types offered;

(f) limiting the opening of new customer accounts;

(g) limiting approvals of registered persons entering into borrowing or lending arrangements with their customers;

(h) requiring the member to impose specific conditions or limitations on, or to prohibit, registered persons' outside business activities of which the member has received notice pursuant to Rule 3270; and

(i) requiring the member to prohibit or, as part of its supervision of approved private securities transactions for compensation under Rule 3280 or otherwise, impose specific conditions on associated persons' participation in private securities transactions of which the member has received notice pursuant to Rule 3280.

* * * * *

9500. OTHER PROCEEDINGS

* * * * *

9550. Expedited Proceedings

* * * * *

9559. Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series

(a) No Change.

(b) Computation of Time

Rule 9138 shall govern the computation of time in proceedings brought under the Rule 9550 Series, except that intermediate Saturdays, Sundays and Federal holidays shall be included in the computation in proceedings brought under Rules 9556 through 9558 and 9561, unless otherwise specified.

(c) Stays

(1) Unless the Chief Hearing Officer or the Hearing Officer assigned to the matter orders otherwise for good cause shown, a timely request for a hearing shall stay the effectiveness of a notice issued under Rules 9551 through 9556 and 9561(b), except that: (A) the effectiveness of a notice of a limitation or prohibition on access to services offered by FINRA or a member thereof under Rule 9555 with respect to services to which the member or person does not have access shall not be stayed by a request for a hearing; and (B) this paragraph has no applicability to a petition instituting an expedited proceeding under Rule 9556(h).

(2) A timely request for a hearing shall stay the effectiveness of a notice issued under Rule 9557 for 10[ten] business days after service of the notice or until the Office of Hearing Officers issues a written order under Rule 9559(o)(4)(A) (whichever period is less), unless FINRA's Chief Executive Officer (or such other executive officer as the Chief Executive Officer may designate) determines that a notice under Rule 9557 shall not be stayed. Where a notice under Rule 9557 is stayed by a request for a hearing, such stay shall remain in effect only for 10[ten] business days after service of the notice or until the Office of Hearing Officers issues a written order under Rule 9559(o)(4)(A) (whichever period is less) and shall not be extended.

(3) No Change.

(4) A timely request for a hearing shall not stay the effectiveness of a notice issued under Rule 9561(a).

(d) Appointment and Authority of Hearing Officer and[/or] Hearing Panel

(1) For proceedings initiated under Rules 9553, 9554, [and] 9556(h) and 9561, the Chief Hearing Officer shall appoint a Hearing Officer to preside over and act as the sole adjudicator for the matter.

(2) through (6) No Change.

(e) Consolidation or Severance of Proceedings

Rule 9214 shall govern the consolidation or severance of proceedings, except that, where one of the notices that are the subject of consolidation under this Rule requires that a hearing be held before a Hearing Panel, the hearing of the consolidated matters shall be held before a Hearing Panel. Where two consolidated matters contain different timelines under this Rule, the Chief Hearing Officer or Hearing Officer assigned to the matter has discretion to determine which timeline is appropriate under the facts and circumstances of the case. Where one of the consolidated matters includes an action brought under a Rule that does not permit a stay of the effectiveness of the notice or where FINRA's Chief Executive Officer (or such other executive officer as the Chief Executive Officer may designate), in the case of Rule 9557, or Hearing Officer, in the case of Rule 9558(d), determines that a request for a hearing shall not stay the effectiveness of the notice, the limitation, prohibition, condition, requirement, restriction, obligation or suspension specified in the notice, or the partial deposit requirement specified in Rule 9561(a)(4), shall not be stayed pending resolution of the case. Where one of the consolidated matters includes an action brought under Rule 9557 that is stayed for up to 10[ten] business days, the requirement [and/]or restriction specified in the notice shall not be further stayed.

(f) Time of Hearing

(1) No Change.

(2) A hearing shall be held within 10[ten] days after a respondent is served a petition seeking an expedited proceeding issued under Rules 9556(h).

(3) A hearing shall be held within 14 days after a respondent subject to a notice issued under Rules 9556 (except Rule 9556(h)), [and] 9558 or 9561(b) files a written request for a hearing with the Office of Hearing Officers.

(4) No Change.

(5) A hearing shall be held within 30 days after a respondent subject to a notice issued under Rule 9561(a) files a written request for a hearing with the Office of Hearing Officers.

([5]6) The timelines established by paragraphs (f)(1) through (f)(5[4]) of this Rule confer no substantive rights on the parties.

(g) Notice of Hearing

The Hearing Officer shall issue a notice stating the date, time, and place of the hearing as follows:

(1) through (2) No Change.

(3) At least seven days prior to the hearing in the case of an action brought pursuant to Rules 9556 (except Rule 9556(h)), [and] 9558 or 9561(b); and

(4) At least 21 days prior to the hearing in the case of an action brought pursuant to Rules 9551 through 9555 or 9561(a).

(h) Transmission of Documents

(1) Not less than two business days before the hearing in an action brought under Rule 9557, not less than six days before the hearing in an action brought under Rule 9556(h), not less than seven days before the hearing in an action brought under Rules 9556 (except Rule 9556(h)), [and] 9558 or 9561(b), and not less than 14 days before the hearing in an action brought under Rules 9551 through 9555 or 9561(a), FINRA staff shall provide to the respondent who requested the hearing or the respondent who has received a petition pursuant to Rule 9556(h), by facsimile, email, overnight courier or personal delivery, all documents that were considered in issuing the notice unless a document meets the criteria of Rule 9251(b)(1)(A), (B), (C) or (b)(2). Documents served by facsimile or email shall also be served by either overnight courier or personal delivery. A document that meets the criteria in this paragraph shall not constitute part of the record, but shall be retained by FINRA until the date upon which FINRA serves a final decision or, if applicable, upon the conclusion of any review by the SEC or the federal courts.

(2) Not less than two business days before the hearing in an action brought under Rule 9557, not less than three days before the hearing in an action brought under Rules 9556, [and] 9558 or 9561(b), and not less than seven days before the hearing in an action brought under Rules 9551 through 9555 or 9561(a), the parties shall exchange proposed exhibit and witness lists. The exhibit and witness lists shall be served by facsimile, email, overnight courier or personal delivery. Documents served by facsimile or email shall also be served by either overnight courier or personal delivery.

(i) through (m) No Change.

(n) Sanctions, Requirements, Costs and Remands

(1) In any action brought under the Rule 9550 Series, other than an action brought under Rule 9556(h), [or] Rule 9557 or Rule 9561, the Hearing Officer or, if applicable, the Hearing Panel may approve, modify or withdraw any and all sanctions, requirements, restrictions or limitations imposed by the notice and, pursuant to Rule 8310(a), may also impose any other fitting sanction.

(2) No Change.

(3) In an action brought under Rule 9557, the Hearing Panel shall approve or withdraw the requirements [and/]or restrictions imposed by the notice. If the Hearing Panel approves the requirements [and/]or restrictions and finds that the respondent has not complied with all of them, the Hearing Panel shall impose an immediate suspension on the respondent that shall remain in effect unless FINRA staff issues a letter of withdrawal of all requirements [and/]or restrictions pursuant to Rule 9557(g)(2).

(4) through (5) No Change.

(6) In any action brought under Rule 9561(a), the Hearing Officer may approve or withdraw any and all of the Rule 4111 Requirements, or remand the matter to the department that issued the notice for further consideration of specified matters, but may not modify any of the Rule 4111 Requirements imposed by the notice or impose any other requirements, obligations or restrictions available under Rule 4111. In any action brought under Rule 9561(b), the Hearing Officer may approve or withdraw the suspension or cancellation of membership, and may impose any other fitting sanction.

(o) Timing of Decision

(1) Proceedings initiated under Rules 9553, [and] 9554 and 9561

Within 60 days of the date of the close of the hearing, the Hearing Officer shall prepare a proposed written decision and provide it to the National Adjudicatory Council's Review Subcommittee.

(2) through (4) No Change.

(5) If not timely called for review by the National Adjudicatory Council's Review Subcommittee pursuant to paragraph (q) of this Rule, the Hearing Officer's or, if applicable, the Hearing Panel's written decision shall constitute final FINRA action. For decisions issued under Rules 9551 through 9556, [and] 9558 or 9561, the Office of Hearing Officers shall promptly serve the decision of the Hearing Officer or, if applicable, the Hearing Panel on the Parties and provide a copy to each FINRA member with which the respondent is associated.

(6) No Change.

(p) Contents of Decision

The decision, which for purposes of Rule 9557 means the written decision issued under paragraph (o)(4)(B) of this Rule, shall include:

(1) through (5) No Change.

(6) a statement describing any sanction, requirement, obligation, restriction or limitation imposed, the reasons therefore, and the date upon which such sanction, requirement, obligation, restriction or limitation shall become effective, if they are not already effective.

(q) through (r) No Change.

9561. Procedures for Regulating Activities Under Rule 4111

(a) Notices Under Rule 4111

(1) Notice of Requirements or Restrictions

FINRA's Department of Member Regulation ("Department") shall issue a notice of its determination under Rule 4111 that a firm is a Restricted Firm and the requirements, conditions or restrictions to which the Restricted Firm is subject (hereinafter, collectively referred to as the "Rule 4111 Requirements").

(2) Service of Notice

FINRA staff shall serve the member subject to a notice issued under this Rule (or upon counsel representing the member, or other person authorized to represent others under Rule 9141, when counsel or other person authorized to represent others under Rule 9141 agrees to accept service for the member) by facsimile, email, overnight courier or personal delivery. Papers served on a member, counsel for such member, or other person authorized to represent others under Rule 9141 by overnight courier or personal delivery shall conform to paragraphs (a)(1) and (3) and, with respect to a member, (b)(2) of Rule 9134. Papers served on a member by facsimile shall be sent to the member's facsimile number listed in the FINRA Contact System submitted to FINRA pursuant to Article 4, Section III of the FINRA By-Laws, except that, if FINRA staff has actual knowledge that a member's FINRA Contact System facsimile number is out of date, duplicate copies shall be sent to the member by overnight courier or personal delivery in conformity with paragraphs (a)(1) and (3) and (b)(2) of Rule 9134. Papers served on a member by email shall be sent to the member's email address listed in the FINRA Contact System submitted to FINRA pursuant to Article 4, Section III of the FINRA By-Laws and shall also be served by either overnight courier or personal delivery in conformity with paragraphs (a)(1) and (3) and (b)(2) of Rule 9134. Papers served on counsel for a member, or other person authorized to represent others under Rule 9141 by facsimile or email shall be sent to the facsimile number or email address that counsel or other person authorized to represent others under Rule 9141 provides and shall also be served by either overnight courier or personal delivery in conformity with paragraphs (a)(1) and (3) of Rule 9134. Service is complete upon sending the notice by facsimile or email, sending the notice by overnight courier or delivering it in person, except that, where duplicate service is required, service is complete upon sending the duplicate service.

(3) Contents of Notice

A notice issued under this Rule shall include the Department's determinations under Rule 4111 and state the specific grounds and include the factual basis for the FINRA action. The notice shall state when the FINRA action will take effect. The notice shall state that the respondent may file a written request for a hearing with the Office of Hearing Officers pursuant to Rule 9559. The notice also shall inform the respondent of the applicable deadline for filing a request for a hearing and shall state that a request for a hearing must set forth with specificity the basis for

eliminating any Rule 4111 Requirements. In addition, the notice shall explain that, pursuant to Rule 9559(n), a Hearing Officer may approve or withdraw any and all of the Rule 4111 Requirements, or remand the matter to the Department that issued the notice for further consideration of specified matters, but may not modify any of the Rule 4111 Requirements imposed by the notice or impose any other obligations or restrictions available under Rule 4111.

(4) Effectiveness of the Rule 4111 Requirements

The Rule 4111 Requirements imposed by a notice issued and served under paragraph (a) of this Rule are immediately effective; provided, however, that when a firm requests review of a Department determination under Rule 4111 that imposes a deposit requirement on the firm for the first time, the firm shall be required to deposit only 25 percent of its restricted deposit requirement or 25 percent of its average excess net capital over the prior year, whichever is less, while the hearing is pending. The Rule 4111 Requirements, and the partial deposit requirement required by Rule 4111 and this paragraph, shall remain in effect while the hearing is pending.

(5) Request for Hearing

A member served with a notice under paragraph (a) of this Rule may file with the Office of Hearing Officers a written request for a hearing pursuant to Rule 9559. A request for a hearing shall be made within seven days after service of the notice issued under this Rule. A request for a hearing must set forth with specificity the basis for eliminating any Rule 4111 Requirements.

(6) Failure to Request Hearing

If a member does not timely request a hearing, the notice under paragraph (a) of this Rule shall constitute final FINRA action.

(b) Notice for Failure to Comply with the Rule 4111 Requirements

(1) Notice of Suspension or Cancellation

If a member fails to comply with any Rule 4111 Requirements imposed under this Rule, the Department, after receiving authorization from FINRA's Chief Executive Officer or such other executive officer as the Chief Executive Officer may designate, may issue a suspension or cancellation notice to such member stating that the failure to comply with the Rule 4111 Requirements within seven days of service of the notice will result in a suspension or cancellation of membership.

(2) Service of Notice

FINRA staff shall serve the member subject to a notice issued under this paragraph (b) in accordance with the service provisions in paragraph (a)(2) of this Rule.

(3) Contents of Notice

The notice shall explicitly identify the Rule 4111 Requirements with which the firm is alleged to have not complied and shall contain a statement of facts specifying the alleged failure. The notice shall state when the suspension will take effect and explain what the respondent must do to avoid such suspension. The notice shall state that the respondent may file a written request for a hearing with the Office of Hearing Officers pursuant to Rule 9559. The notice also shall inform the respondent of the applicable deadline for filing a request for a hearing and shall state that a request for a hearing must set forth with specificity any and all defenses to the FINRA action. In addition, the notice shall explain that, pursuant to Rules 8310(a) and 9559(n), a Hearing Officer may approve or withdraw the suspension or cancellation of membership, and may impose any other fitting sanction.

(4) Effective Date of Suspension or Cancellation

The suspension or cancellation referenced in a notice issued and served under paragraphs (b)(1) and (b)(2) of this Rule shall become effective seven days after service of the notice, unless stayed by a request for hearing pursuant to Rule 9559.

(5) Request for a Hearing

A member served with a notice under paragraphs (b)(1) and (b)(2) of this Rule may file with the Office of Hearing Officers a written request for a hearing pursuant to Rule 9559. A request for a hearing shall be made before the effective date of the notice, as indicated in paragraph (b)(4) of this Rule. A request for a hearing must set forth with specificity any and all defenses to the FINRA action.

(6) Failure to Request Hearing

If a member does not timely request a hearing, the suspension or cancellation specified in the notice shall become effective seven days after the service of the notice and the notice shall constitute final FINRA action.

(7) Request for Termination of the Suspension

A member subject to a suspension imposed after the process described in paragraphs (b)(1) through (6) of this Rule may file a written request for termination of the suspension on the ground of full compliance with the notice or decision. Such request shall be filed with the head of the Department. The head of the Department may grant relief for good cause shown.

• • • Supplementary Material: ----------

.01 Application to Former Members Under Rule 4111. For purposes of this Rule, the term member also shall include a "Former Member" as defined in Rule 4111(i) as applicable.

* * * * *

Capital Acquisition Broker Rules

* * * * *

400. FINANCIAL AND OPERATIONAL RULES

* * * * *

412. Restricted Firm Obligations

All capital acquisition brokers are subject to FINRA Rule 4111.

* * * * *

Funding Portal Rules

* * * * *

900. Code of Procedure.

(a) Application of FINRA Rule 9000 Series (Code of Procedure) to Funding Portals

Except for the FINRA Rule 9520 Series, FINRA Rule 9557, FINRA Rule 9561, and the FINRA Rule 9700 Series, all funding portal members shall be subject to the FINRA Rule 9000 Series, unless the context requires otherwise, provided, however, that:

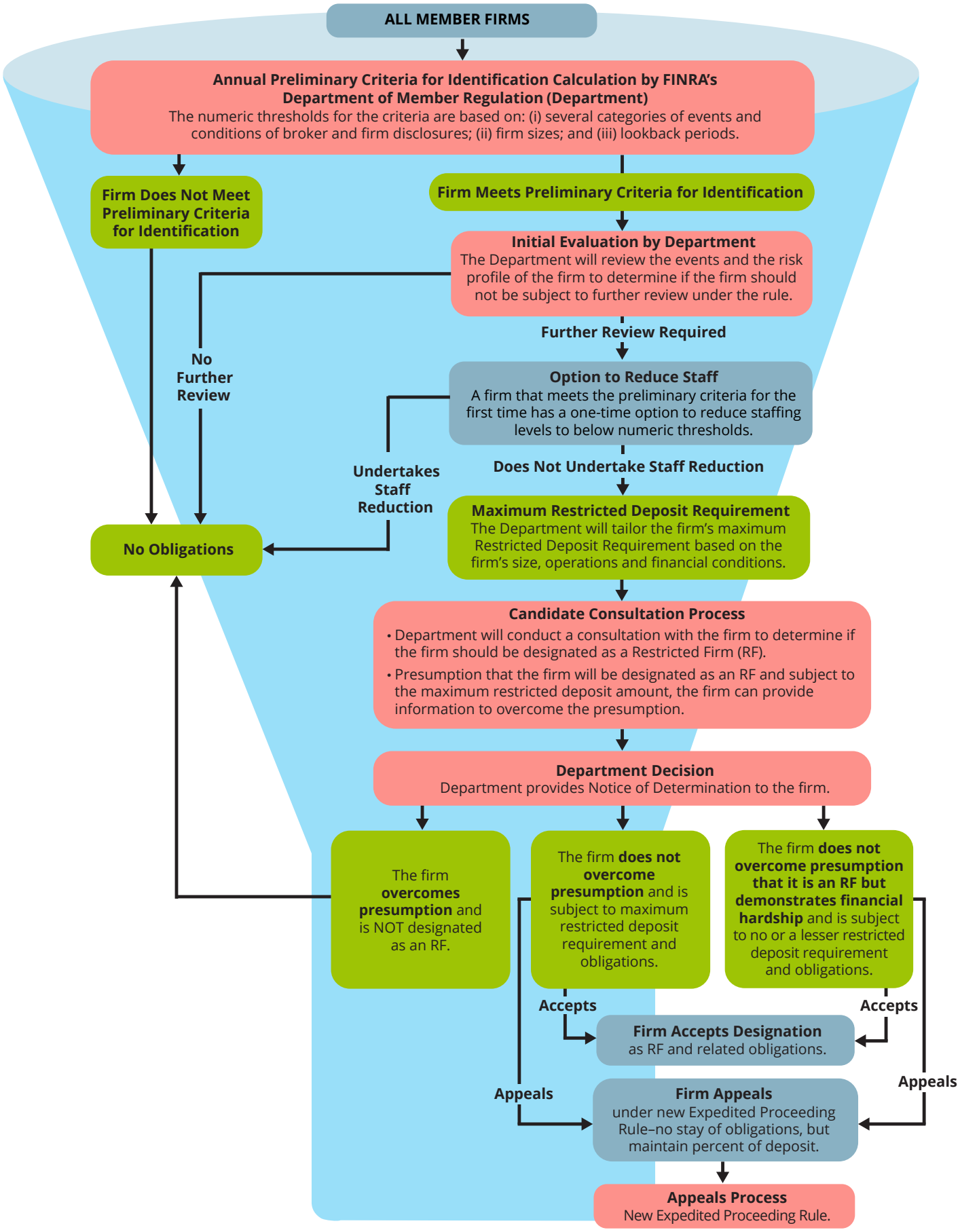
(1) through (9) No Change.

(b) No Change.

* * * * *

Attachment B

Rule 4111 (Restricted Firm Obligations)



Brokers With a Significant History of Misconduct
Thursday, December 9
2:30 p.m. – 3:00 p.m.

Join FINRA staff as the discuss the new broker with significant history of misconduct obligations. Panelists review the implications of retaining or hiring brokers with such a history.

Moderator:
Kristin Ferrante
Principal Analyst, Risk Monitoring – Jericho Office
FINRA Member Supervision

Panelists:
Jennifer Crawford
Vice President, Litigation
FINRA Enforcement

Jennifer Danby
Application Manager, MAP
FINRA Member Supervision

Paxton Dunn
Manager, Risk Monitoring – Dallas Office
FINRA Member Supervision

Brokers With a Significant History of Misconduct Panelist Bios:

Moderator:

Kristin Ferrante is Risk Monitoring Principal Analyst in FINRA's Member Supervision department. Ms. Ferrante joined FINRA 11 years ago. Prior to FINRA, she served as a Vice President within the Compliance department at Citi Alternative Investments. Prior to that, she began her career as an examiner at the New York Stock Exchange. Ms. Ferrante graduated from Syracuse University with a degree in Finance and Economics.

Panelists:

Jen Crawford is Vice President of Litigation in the Enforcement Department, responsible for overseeing Enforcement's nationwide litigation and appellate programs. Prior to assuming this role, she was a Hearing Officer in FINRA's Office of Hearing Officers. Ms. Crawford joined FINRA in 2012 and was a Director in Enforcement until 2018. Prior to joining FINRA, she was a Senior Counsel in the Division of Enforcement at the U.S. Securities and Exchange Commission where she investigated and litigated enforcement matters in federal court and in administrative proceedings. Ms. Crawford holds a B.S. in Finance from Seton Hall University and J.D. from Catholic University.

Jennifer Danby joined the FINRA New York office in 2010 and has acted as a Manager in the Membership Application Program (MAP) Group since 2012. The MAP Group is responsible for the review of New Member and Continuing Member Applications as well as other matters for FINRA firms. Prior to this, Ms. Danby spent more than 10 years in the financial services industry, with a primary focus on anti-money laundering and sales practice compliance.

Paxton Dunn, Manager Risk Monitoring Standards, has spent more than 20 years in the financial services industry with 18 years at FINRA. In July 2020 Mr. Dunn began his current role, where he is responsible for management of centralized risk monitoring functions and ensuring policies and procedures are appropriate and consistent across FINRA's risk monitoring program. Prior to his current role, he was a Risk Monitoring Analyst in Dallas Office for 10 years and an examiner in the Dallas office for seven years. Before coming to FINRA, Mr. Dunn spent 18 months as an Account Executive for CitiStreet. In 2002, Mr. Dunn earned his BBA in Finance from Angelo State University. In May 2017 he became a Certified Anti-Money laundering Specialist (CAMS), and in June 2021 a Certified Fraud Examiner (CFE). Outside of FINRA, Mr. Dunn is involved with various charities, and is currently a Board Member for the Epilepsy Foundation of Texas.

Brokers With a Significant History of Misconduct

Panelists

- **Moderator**
  - Kristin Ferrante, Principal Analyst, Risk Monitoring – Jericho Office, FINRA Member Supervision
- **Panelists**
  - Jennifer Crawford, Vice President, Litigation, FINRA Enforcement
  - Jennifer Danby, Application Manager, MAP, FINRA Member Supervision
  - Paxton Dunn, Manager, Risk Monitoring – Dallas Office, FINRA Member Supervision

Brokers With a Significant History of Misconduct
Thursday, December 9
2:30 p.m. – 3:00 p.m.

Resource:

- FINRA Webpage: Checklists for Mandatory Materiality Consultations Under Rules 1017(a)(6) and 1017(a)(7)

  www.finra.org/rules-guidance/guidance/materiality-consultation-process/checklist-under-rules-1017a6_a7

Regulatory Notice 21-09

Protecting Investors From Misconduct

FINRA Adopts Rules to Address Brokers With a Significant History of Misconduct

Effective Dates: Amendments to the FINRA Rule 9200 Series, FINRA Rule 9300 Series, and FINRA Rule 9556: April 15, 2021; Amendments to FINRA Rule 8312: May 1, 2021; Amendments to the FINRA Rule 9520 Series and Funding Portal Rule 900: June 1, 2021; Amendments to the FINRA Rule 1000 Series and the Capital Acquisition Broker Rule 100 Series: September 1, 2021

Executive Summary

FINRA has adopted new rules to address brokers with a significant history of misconduct and the broker-dealers that employ them.[1] The new rules:

- allow a Hearing Officer to impose conditions or restrictions on the activities of a Respondent member firm or Respondent associated person, and require the member firm employing a Respondent associated person to adopt heightened supervisory procedures for such an associated person, when a disciplinary matter is appealed to the National Adjudicatory Council (NAC) or called for NAC review;
- require member firms to adopt heightened supervisory procedures for statutorily disqualified associated persons during the period a statutory disqualification eligibility request is under review by FINRA;
- require disclosure through FINRA BrokerCheck® of the status of a member firm as a "taping firm" under FINRA Rule 3170 (Tape Recording of Registered Persons by Certain Firms); and
- require a member firm to submit a written request to FINRA's Department of Member Regulation, through the Membership Application Group, seeking a materiality consultation and approval of a continuing membership application, if required, when a natural person seeking to become an owner, control person, principal or registered person of the member firm has, in the prior five years, one or more "final criminal matters" or two or more "specified risk events."

March 10, 2021

Notice Type

- New Rule

Suggested Routing

- Compliance
- Legal
- Operations
- Registered Representatives
- Registration
- Senior Management

Key Topics

- BrokerCheck
- Brokers With a Significant History of Misconduct
- Conditions and Restrictions
- Continuing Membership Applications
- Disciplinary Proceedings
- Eligibility Proceedings
- Expedited Proceedings
- Heightened Supervision
- Materiality Consultations
- Taping Firm
- Taping Rule

Referenced Rules & Notices

- CAB Rule 111
- FINRA Rules 1011, 1017, 3170, 8312, 9235, 9285, 9311, 9312, 9321, 9522 and 9556
- Funding Portal Rule 900
- IM-1011-1
- IM-1011-3
- Regulatory Notices 18-15, 18-16 and 18-17
- Securities Exchange Act of 1934

The amendments to the FINRA Rule 9200 Series (Disciplinary Proceedings), the FINRA Rule 9300 Series (Review of Disciplinary Proceeding by National Adjudicatory Council and FINRA Board; Application for SEC Review), and FINRA Rule 9556 (Failure to Comply with Temporary and Permanent Cease and Desist Orders, or Orders that Impose Conditions or Restrictions) become effective April 15, 2021.

The amendments to FINRA Rule 8312 (FINRA BrokerCheck Disclosure) become effective May 1, 2021.

The amendments to the FINRA Rule 9520 Series (Eligibility Proceedings) and Funding Portal Rule 900 (Code of Procedure) become effective June 1, 2021.

The amendments to the FINRA Rule 1000 Series (Member Application and Associated Person Registration), the Capital Acquisition Broker Rule 100 Series (Member Application and Associated Person Registration) become effective September 1, 2021.

The rule text is available in Attachment A.

Questions concerning this *Notice* should be directed to:

- Kosha Dalal, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-6903 or *Kosha.Dalal@finra.org*; or
- Michael Garawski, Associate General Counsel, OGC, at (202) 728-8835 or *Michael.Garawski@finra.org*.

Background & Discussion

FINRA uses a combination of tools to reduce the risk of harm to investors from member firms and the brokers they hire that have a history of misconduct. These tools include assessments of applications member firms file to retain or employ an individual subject to a statutory disqualification, reviews of membership and continuing membership applications (CMAs), disclosure of brokers' regulatory backgrounds, supervision requirements, focused examinations, risk monitoring and disciplinary actions.

For several years, FINRA has been taking steps to strengthen its tools for responding to brokers with a significant history of misconduct and the firms that employ them. As part of this initiative, FINRA has:

- published *Regulatory Notice 18-15* (Heightened Supervision), which reiterates the existing obligation of member firms to implement for such individuals tailored heightened supervisory procedures under Rule 3110 (Supervision);
- published *Regulatory Notice 18-17* (FINRA Revises the Sanction Guidelines), which announced revisions to the FINRA Sanction Guidelines;
- raised fees for statutory disqualification applications;[2]

- revised the qualification examination waiver guidelines to permit FINRA to more broadly consider past misconduct when considering examination waiver requests;[3] and
- proposed rule changes to address member firms with a significant history of misconduct.[4]

The new rules establish additional investor protections against individuals with a significant history of misconduct and the firms that employ them.

Enhancing Investor Protection During the Pendency of an Appeal or Call-for-Review Proceeding

FINRA has amended the Rule 9200 Series (Disciplinary Proceedings) and the Rule 9300 Series (Review of Disciplinary Proceeding by National Adjudicatory Council and FINRA Board; Application for SEC Review) to address investor protection concerns during the pendency of an appeal, or National Adjudicatory Council (NAC) review of, a Hearing Panel or Hearing Officer disciplinary decision, by (1) authorizing Hearing Officers to impose conditions and restrictions on disciplined Respondents and (2) requiring member firms to adopt heightened supervision plans concerning their associated persons who are disciplined Respondents.

Conditions and Restrictions

New Rule 9285 authorizes the imposition of conditions or restrictions on disciplined Respondents during the pendency of an appeal or call for review of a disciplinary decision, where reasonably necessary for the purpose of preventing customer harm. The conditions and restrictions would target the misconduct demonstrated in the disciplinary proceeding and be tailored to the specific risks the Respondent poses during the appeal period.[5]

Hearing Officers can impose conditions or restrictions during the period an appeal or review proceeding is pending to target the demonstrated bad conduct of a Respondent during the pendency of the appeal or review and add an interim layer of investor protection while the disciplinary proceeding remains pending. Conditions and restrictions will help protect investors by potentially preventing associated persons and firms found to have violated a statute or rule from engaging in additional misconduct during the appeal process.

Rule 9285(a) governs the seeking of, and imposition by a Hearing Officer of, conditions and restrictions. The rule provides that, within 10 days after service of a notice of appeal from, or the notice of a call for NAC review of, a disciplinary decision in which a Hearing Officer or Hearing Panel finds that a Respondent violated a statute or a rule provision, the Department of Enforcement (Enforcement) may file a motion for the imposition of conditions or restrictions on the activities of a Respondent that are reasonably necessary for the purpose of preventing customer harm. The rule further provides that the Hearing Officer who participated in an underlying disciplinary proceeding shall have jurisdiction to rule upon a motion for the imposition of conditions or restrictions.

Rule 9285(b) sets forth the process for an expedited review of a Hearing Officer order that imposes conditions and restrictions. The rule allows a Respondent to file, within 10 days after service of a Hearing Officer order imposing conditions or restrictions, a motion with the NAC's Review Subcommittee to modify or remove any or all of the conditions or restrictions. In any such motion, the Respondent has the burden to show that the conditions or restrictions imposed are not reasonably necessary for the purpose of preventing customer harm. The rule further provides that the Review Subcommittee has the authority to approve, modify or remove any and all of the conditions or restrictions, and that the filing of a motion to modify or remove conditions or restrictions shall stay the effectiveness of the conditions or restrictions until the Review Subcommittee rules on the motion. The rule contains other procedural provisions concerning the motions process and the deadlines for issuing written orders and rulings.[6]

Unlike sanctions that a Hearing Panel or a Hearing Officer imposes, which are automatically stayed and not enforced against the Respondent during the pendency of the NAC appeal or review proceeding,[7] conditions and restrictions imposed pursuant to Rule 9285 remain in place until FINRA's final decision takes effect and all appeals are exhausted.[8]

FINRA also has amended and retitled Rule 9556 (Failure to Comply with Temporary and Permanent Cease and Desist Orders, or Orders that Impose Conditions or Restrictions). Prior to the amendments, Rule 9556 governed only expedited proceedings for failures to comply with temporary and permanent cease and desist orders. The amendments to Rule 9556 grant FINRA staff the authority to bring an expedited proceeding against a Respondent that fails to comply with conditions and restrictions imposed pursuant to Rule 9285 and create the process for the new expedited proceeding.[9]

Mandatory Heightened Supervision

To further bolster investor protection during the pendency of an appeal from, or a NAC review of, a Hearing Panel or Hearing Officer disciplinary decision, new Rule 9285 also requires member firms to adopt a written heightened supervision plan for an associated person who is found to have violated a statute or rule provision in a disciplinary decision, when that disciplinary decision has been appealed or called for NAC review.[10] The plan of heightened supervision shall remain in place until FINRA's final disciplinary decision takes effect.[11]

The new rule requires that the plan of heightened supervision, and any amended plan, comply with FINRA Rule 3110 (Supervision), be reasonably designed and tailored to include specific supervisory policies and procedures that address the violations the Hearing Panel or Hearing Officer finds; be reasonably designed to prevent or detect a reoccurrence of these violations; at a minimum, include the designation of an appropriate registered principal who is responsible for carrying out the plan of heightened supervision, and take

into account any conditions and restrictions the Hearing Officer or Review Subcommittee imposes; and be signed by the designated principal.[12] The new rule also establishes deadlines for when the member firm, and other member firms with which the Respondent associates, must file the written plan of heightened supervision with FINRA and provides instructions on how to do so.[13]

The amendments to the FINRA Rule 9200 Series (Disciplinary Proceedings), the FINRA Rule 9300 Series (Review of Disciplinary Proceeding by National Adjudicatory Council and FINRA Board; Application for SEC Review), and FINRA Rule 9556 (Failure to Comply with Temporary and Permanent Cease and Desist Orders, or Orders that Impose Conditions or Restrictions) apply to disciplinary proceedings and expedited proceedings that are commenced, by the filing of a complaint or the issuance of a notice, on or after April 15, 2021.

Enhancing Investor Protection During the Period When FINRA Is Reviewing an Eligibility Application

FINRA has amended and retitled FINRA Rule 9522 (Initiation of Eligibility Proceeding; Member Regulation Consideration; and Requirements for an Interim Plan of Heightened Supervision) in the FINRA Rule 9520 Series (Eligibility Proceedings) to require a member firm that files an application to continue associating with a disqualified person to also include an interim plan of heightened supervision that would be in effect throughout the entirety of the application review process.

As background, the Securities Exchange Act of 1934 (Exchange Act) sets out the types of misconduct that presumptively exclude brokers from engaging in the securities business, identified as statutory disqualifications.[14] The Exchange Act and SEC rules thereunder establish a framework within which FINRA evaluates whether to allow an individual who is subject to a statutory disqualification to associate with a member firm.[15] A member firm that seeks to employ or continue the employment of a disqualified individual must file an application seeking approval from FINRA (SD Application).[16] The Rule 9520 Series sets forth rules governing eligibility proceedings, in which FINRA evaluates whether to allow a member, person associated with a member, potential member or potential associated person subject to a statutory disqualification to enter or remain in the securities industry. As part of an SD Application, a member firm will propose a written plan of heightened supervision of the statutorily disqualified person that would become effective upon FINRA's approval of the SD Application to associate with the statutorily disqualified person. Generally, the continued association of a statutorily disqualified person approved through a FINRA eligibility proceeding is conditioned on the individual being subject to a heightened supervision plan.[17]

Previously, FINRA issued guidance that a member firm's continuing to associate with a person who becomes disqualified while associated with the firm raises significant investor protection concerns, and that such a firm should evaluate the facts and circumstances

to make a determination of whether adopting and implementing an interim plan of heightened supervision during the pendency of an SD Application would be appropriate.[18] FINRA has amended Rule 9522 to require such interim plans of heightened supervision.

Under Rule 9522(f), an application to continue associating with a statutorily disqualified person[19] must include an interim plan of heightened supervision, signed by the appropriately registered principal, and a written representation from the member firm that the statutorily disqualified person is currently subject to that plan. The interim plan of heightened supervision shall be in effect throughout the entirety of the application review process, which shall be concluded only upon the final resolution of the eligibility proceeding.[20] By requiring interim plans of heightened supervision during an eligibility proceeding, the new rule will help limit the potential for customer harm at an earlier point in time and thereby help protect customers.

The amendments to Rule 9522 apply to SD Applications that are filed on or after the effective date of the rule amendments.

FINRA will be amending the MC-400 (Membership Continuance Application) to make changes on that form that correspond to the amendments to the Rule 9520 Series. These changes will include the addition of a link to sample interim plans of heightened supervision.

Enhanced Disclosure on BrokerCheck of Taping Firms

FINRA has amended Rule 8312 (FINRA BrokerCheck Disclosure), which governs the information FINRA releases to the public through its BrokerCheck® system, to enhance the disclosure of which firms are "taping firms."[21]

FINRA Rule 3170 (Tape Recording of Registered Persons by Certain Firms), also called the Taping Rule, is designed to ensure that a member firm with a significant number of registered persons that previously were employed by "disciplined firms"[22] has specific supervisory procedures in place to prevent fraudulent and improper sales practices or other customer harm. Under the Taping Rule, a member firm with a specified percentage of registered persons who have been associated with disciplined firms in a registered capacity in the last three years is designated as a "taping firm." A member firm that either is notified by FINRA or otherwise has actual knowledge that it is a taping firm must establish, maintain and enforce special written procedures for supervising the telemarketing activities of all its registered persons. Those procedures must include procedures for recording all telephone conversations between the taping firm's registered persons and both existing and potential customers, and for reviewing the recordings to ensure compliance with applicable securities laws and regulations and applicable FINRA rules. The Taping Rule also requires taping firms to retain all the recordings for a period of not less than three years and file quarterly reports with FINRA.

Prior to the amendments, Rule 8312(b) required that FINRA release information about, among other things, whether a particular member firm is subject to the provisions of the Taping Rule, but only in response to telephonic inquiries via the BrokerCheck toll-free telephone listing. To provide enhanced disclosure to the public, FINRA has deleted the requirement that FINRA provide that information only in response to telephonic inquiries. As a result, amended Rule 8312(b) requires FINRA to release through BrokerCheck information as to whether a particular member firm is subject to the Taping Rule. Broadening the disclosure through BrokerCheck of the status of a member firm as a taping firm will help inform more investors of the heightened procedures required of a taping firm, which may incent the investors to research more carefully the background of a broker associated with the taping firm. Information that a firm is a taping firm will be displayed on a firm's BrokerCheck report in the summary section, and in ".pdf" versions of a firm's BrokerCheck report. Specifically, those reports will include the text, "This firm is subject to FINRA Rule 3170 (Taping Rule)," in a color or font that is prominent. The alert also will include the text "Click here for more information," with a hyperlink to a page on FINRA's website that provides a clear explanation of the Taping Rule, to help investors understand why the taping firm is subject to heightened procedures.[23]

New Obligations on Member Firms That Seek Associations With Persons With a Significant History of Misconduct

FINRA has amended rules in the FINRA Rule 1000 Series (Member Application and Associated Person Registration)—specifically the rules that govern membership proceedings (MAP Rules)—to impose additional obligations on member firms when a natural person who has, in the prior five years, either one or more "final criminal matters" or two or more "specified risk events" seeks to become an owner, control person, principal or registered person of the member firm.

As background, Rule 1017(a) specifies the changes in a member's ownership, control or business operations that require a CMA and FINRA's approval. A CMA is required for, among other changes, a "material change in business operations."[24] In addition, a CMA is required for business expansions to increase the number of associated persons involved in sales, offices or markets made that are a material change in business operations.[25] However, Interpretive Material IM-1011-1 (Safe Harbor for Business Expansions) creates a safe harbor for incremental increases in these three categories of business expansions. Under this safe harbor provision, a member firm, subject to specified conditions and thresholds, may undergo such business expansions without filing a CMA.[26]

Given recent studies that provide evidence of the predictability of future regulatory-related events for brokers with a history of past regulatory-related events,[27] FINRA has been concerned about instances where a member firm on-boards brokers with a significant history of misconduct and does so within the safe-harbor parameters, thus avoiding prior consultation or review by FINRA. FINRA believes there are instances in which a member

firm's hiring of a broker with a significant history of misconduct—and other associations with such persons—would reflect a material change in business operations. FINRA has amended the MAP Rules to address these concerns and limit the applicability of the IM-1011-1 safe harbor.

Specifically, FINRA has added Rule 1017(a)(7) to require a member firm to file a CMA when a natural person seeking to become an owner,[28] control person,[29] principal or registered person of the member firm has, in the prior five years, one or more "final criminal matters" or two or more "specified risk events"—as defined in amendments to Rule 1011 (Definitions)[30]—unless the member firm has submitted a written request to Member Regulation seeking a materiality consultation for the contemplated activity.[31] Rule 1017(a)(7) applies whether the person is seeking to become an owner, control person, principal or registered person at the person's current member firm or at a new member firm. Rule 1017(a)(7) does not apply, however, when a person is already a representative at a member firm and seeks to add an additional representative-level registration at that same firm or, likewise, when a person is already a principal at a member firm and seeks to add an additional principal registration at that same firm.

Rule 1017(a)(7) is intended to apply to associated persons and owners who may pose greater risks to customers than other associated persons and owners.[32] The rule is based on disclosure events required to be reported on the Uniform Registration Forms. To assist firms' compliance with Rule 1017(a)(7), FINRA will publish shortly on its website a chart that maps the events described in the definitions of "final criminal matter" and "specified risk event" to the relevant disclosure questions and fields on the Uniform Registration Forms. This mapping guidance will be updated as needed.

These amendments to the MAP Rules add a category of "mandatory materiality consultations."[33] A request for a materiality consultation, for which there is no fee, is a written request from a member firm for FINRA's determination on whether a contemplated change in business operations or activities is material and would therefore require a CMA. The characterization of a proposed change as material depends on an assessment of all the relevant facts and circumstances. Through the materiality consultation, FINRA may communicate with the member firm to obtain further documents and information regarding the contemplated change and its anticipated impact on the member firm. A letter seeking a mandatory materiality consultation under Rule 1017(a)(7) must be submitted through FINRA Gateway®, under the Materiality Consultation section.[34]

A written request for a materiality consultation pursuant to Rule 1017(a)(7) must address the issues that are central to the materiality consultation. Thus, the materiality consultation would focus on, and the member firm would need to provide information relating to, the conduct underlying the individual's "final criminal matters" and "specified risk events," as well as other matters relating to the subject person, such as disciplinary actions taken by FINRA or other industry authorities, adverse examination findings,

customer complaints, pending or unadjudicated matters, terminations for cause or other incidents that could indicate a threat to public investors. The Department of Member Supervision's (Member Supervision) assessment in the materiality consultation would consider, among other things:

- whether the "final criminal matters" or "specified risk events" are customer-related;
- whether they represent discrete actions or are based on the same underlying conduct;
- the anticipated activities of the person;
- the disciplinary history, experience and background of the proposed supervisors, if applicable;
- the disciplinary history, supervisory practices, standards, systems and internal controls of the member firm and whether they are reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules;
- whether the member firm employs or intends to employ in any capacity multiple persons with one or more "final criminal matters" or two or more "specified risk events" in the prior five years; and
- any other investor protection concerns raised by seeking to make the person an owner, control person, principal or registered person of the member firm.

FINRA will be posting on its website a checklist to assist a member firm when it is required to submit a materiality consultation under Rule 1017(a)(7).

Where FINRA determines in a materiality consultation that a contemplated organizational change is not material, the member firm may effect the contemplated activity. Where FINRA determines that the contemplated change requires a CMA, FINRA would instruct the member firm to file a Form CMA if it intends to proceed with such change, and the member firm may not effect the contemplated activity unless Member Supervision approves the Form CMA.[35] FINRA is separately developing changes to Form CMA to incorporate questions that relate specifically to Rule 1017(a)(7).

Rule 1017(a)(7) also establishes that the safe harbor for business expansions in IM-1011-1 is not available to the member firm when a materiality consultation is required under Rule 1017(a)(7). In a corresponding change, FINRA has added IM-1011-3 (Business Expansions and Persons with Specified Risk Events), which provides that the safe harbor for business expansions in IM-1011-1 is not available to any member firm that is seeking to add a natural person who has, in the prior five years, one or more "final criminal matters" or two or more "specified risk events" and seeks to become an owner, control person, principal, or registered person of the member firm. In such circumstances, if the member firm is not otherwise required to file a Form CMA in accordance with Rule 1017, the member firm must comply with the requirements of Rule 1017(a)(7).

The amendments to the MAP Rules further promote investor protection by applying additional safeguards and disclosure obligations for a member firm's continuing membership and for changes to a current member firm's ownership, control, or business operations. The heightened scrutiny by FINRA of registered representatives, registered principals, owners, and control persons who meet the definitions and criteria will promote investor protection by disincentivizing broker-dealers from engaging in higher-risk activity that could lead to additional regulatory restrictions.[36]

Capital Acquisition Brokers (CABs) and Funding Portals

The rule changes described above impact all member firms, including ones that are funding portals or have elected to be treated as capital acquisition brokers (CABs), given that the funding portal rule set incorporates the Rule 9200 Series and Rule 9300 Series and Rule 9556 by reference, and the CAB rule set incorporates Rules 1011, 1017 and 8312 and the Rule 9200 Series, Rule 9300 Series and Rule 9500 Series by reference. In addition, FINRA has amended CAB Rule 111, to reflect that a CAB would be subject to IM-1011-3, and has amended Funding Portal Rule 900(b) to require heightened supervision during the time an eligibility request is pending.

Endnotes

1. *See* Securities Exchange Act Release No. 90635 (December 10, 2020), 85 FR 81540 (December 16, 2020) (Order Approving File No. SR-FINRA-2020-011, as Modified by Amendment No. 1) (Approval Order).
2. *See* Securities Exchange Act Release No. 83181 (May 7, 2018), 83 FR 22107 (May 11, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2018-018).
3. *See Regulatory Notice 18-16* (April 2018).
4. *See* Securities Exchange Act Release No. 90527 (November 27, 2020), 85 FR 78540 (December 4, 2020) (Notice of Filing of File No. SR-FINRA-2020-041).
5. The conditions and restrictions are not intended to be as restrictive as the underlying sanctions imposed in the disciplinary decision and would likely not be economically equivalent to imposing the sanctions during the appeal. *See* Approval Order, 85 FR 81542.
6. *See* Rule 9285(a)(1)-(5), Rule 9285(b)(1)-(5).
7. *See* Rules 9311(b) and 9312(b); *see also* Rule 9370(a) (providing that the filing of an application for review by the SEC shall stay the effectiveness of any sanction, other than a bar or expulsion, imposed in a decision constituting final disciplinary action of FINRA).
8. *See* Rule 9285(d).
9. FINRA also has made amendments to four existing rules to correspond to new Rule 9285: Rules 9235 (Hearing Officer Authority), 9311 (Appeal by Any Party; Cross-Appeal), 9312 (Review Proceeding Initiated by Adjudicatory Council), and 9321 (Transmission of Record).
10. *See* Rule 9285(e).
11. *See* Rule 9285(e)(4).
12. *See* Rule 9285(e)(2) and (3).
13. *See* Rule 9285(e)(1).
14. Section 3(a)(39) of the Exchange Act defines the circumstances when a person is subject to a "statutory disqualification."
15. *See* 15 U.S.C. 78o-3(g)(2) ("A registered securities association may, and in cases in which the Commission, by order, directs as necessary or appropriate in the public interest or for the protection of investors shall, deny membership to any registered broker or dealer, and bar from becoming associated with a member any person, who is subject to a statutory disqualification."); *see also* 17 CFR 240.19h-1.
16. *See* Rule 9522; *see also* General Information on FINRA's Eligibility Requirements.
17. *See* General Information on FINRA's Eligibility Requirements, *supra* (explaining that "in virtually every application that the NAC approves, it will do so subject to the applicant member's agreement to implement a special supervisory plan").
18. *See Regulatory Notice 18-15* (April 2018).
19. *See* Rule 9522(a)(3) and (b)(1)(B).
20. Rule 9522 also has been amended to add provisions concerning determinations by the Department of Member Regulation (Member Regulation) that an SD Application that seeks the continued association of a disqualified person is substantially incomplete, and the consequences for failing to timely remedy a substantially incomplete application. *See* Rule 9522(f), (g), (h).

21. BrokerCheck helps investors make informed choices about the brokers and member firms with which they conduct business by providing extensive registration and disciplinary history to investors at no charge. FINRA requires member firms to inform their customers of the availability of BrokerCheck.

22. *See* Rule 3170(a)(2) (Taping Rule definition of "disciplined firm").

23. The description of the Taping Rule has been added to finra.org. *See* https://www.finra.org/taping-rule.

24. *See* Rule 1017(a)(5); *see also* Rule 1011(m) (setting forth a non-exhaustive list of events that are material changes in business operations).

25. *See* Rule 1017(b)(2)(C) ("If the application requests approval of an increase in Associated Persons involved in sales, offices, or markets made, the application shall set forth the increases in such areas during the preceding 12 months.").

26. The safe harbor is unavailable to a member firm that has a membership agreement that contains a specific restriction as to one or more of the three areas of expansion or to a member firm that has a "disciplinary history" as defined in IM-1011-1. The safe harbor also is not available to any member firm that is seeking to add one or more "associated persons involved in sales" and one or more of those associated persons has a "covered pending arbitration claim," an unpaid arbitration award or unpaid settlement related to an arbitration. *See* Rule 1017(a)(6)(B); IM-1011-2 (Business Expansions and Covered Pending Arbitration Claims).

27. In 2015, FINRA's Office of the Chief Economist (OCE) published a study that examined the predictability of disciplinary and other disclosure events associated with investor harm based on past similar events. The OCE study showed that past disclosure events, including regulatory actions, customer arbitrations and litigations of brokers, have significant power to predict future investor harm. *See* Hammad Qureshi & Jonathan Sokobin, *Do Investors Have Valuable Information About Brokers?* (FINRA OCE Working Paper, Aug. 2015). A subsequent academic research paper presented evidence that suggests a higher rate of new disciplinary and other disclosure events is highly correlated with past disciplinary and other disclosure events, as far back as nine years prior. *See* Mark Egan, Gregor Matvos, & Amit Seru, *The Market for Financial Adviser Misconduct*, J. Pol. Econ. 127, no. 1 (Feb. 2019): 233-295.

28. Rule 1017(a)(7) defines "owner," for purposes of Rule 1017(a)(7), to have the same meaning as "direct owner" and "indirect owner" on the Uniform Application for Broker-Dealer Registration (Form BD), Schedules A and B, as amended from time to time.

29. Rule 1017(a)(7) defines "control person" to mean a person who would have "control" as defined on Form BD, as amended from time to time.

30. *See* Rule 1011(h) (defining "final criminal matter"); Rule 1011(p) (defining "specified risk event"). The definitions of "final criminal matter" and "specified risk events" are based on criminal events, arbitration awards, civil judgments, arbitration settlements, civil litigation settlements, civil judicial actions, and regulatory actions, as described in the definitions, that are disclosed, or are or were required to be disclosed,

on the "Uniform Registration Forms." *See* Rule 1011(r) (defining "Uniform Registration Forms" to include the Form BD, the Uniform Application for Securities Industry Registration or Transfer (Form U4), the Uniform Termination Notice of Securities Industry Registration (Form U5), and the Uniform Disciplinary Action Reporting Form (Form U6)).

31. By its terms, Rule 1017(a)(7) does not apply when the member firm is required to file an SD Application or written request for relief pursuant to Rule 9522 (Initiation of Eligibility Proceeding; Member Regulation Consideration; and Requirements for an Interim Plan of Heightened Supervision) for approval of the same contemplated association.

32. *See* Securities Exchange Act Release No. 88600 (April 8, 2020), 85 FR 20745, 20758 (April 14, 2020) (Notice of Filing of File No. SR-FINRA-2020-011). FINRA developed the Rule 1017(a)(7) criteria and the definitions of "final criminal matter" and "specified risk event" with significant attention to the economic trade-off between including individuals who are less likely to subsequently pose risk of harm to customers, and not including individuals who are more likely to subsequently pose risk of harm to customers. *See id.* at 20754, 20758-59.

33. Other mandatory materiality consultations are required by Rule 1017(a)(6).

34. For technical assistance, please contact the FINRA Gateway Call Center at (301) 869-6699.

35. *See also* Rule 1017(b)(2) (requiring a member firm to submit a CMA that includes a Form CMA).

36. *See* Approval Order, 85 FR at 81546.

Mapping of Disclosure Categories for FINRA Rule 1017(a)(7)

The table below is intended to help member firms determine whether a continuing membership application (Form CMA) or materiality consultation is required to be submitted to the Department of Member Supervision, Membership Application Group (MAP), to comply with FINRA Rule 1017(a)(7) by mapping the disclosure events relevant for the rule to the Uniform Registration Forms (i.e., Forms U4, U5, U6, and BD).

Pursuant to FINRA Rule 1017(a)(7), unless the member firm has submitted a written request to the Department of Member Supervision seeking a materiality consultation for the contemplated activity, a member firm is required to file a Form CMA whenever a natural person seeking to become an owner, control person, principal or registered person of a member firm has, in the prior five years, a record of one or more "final criminal matters" or two or more "specified risk events." The terms "final criminal matter" and "specified risk event," which are defined in FINRA Rule 1011, are based on events that are disclosed, or are or were required to be disclosed, on any of the Uniform Registration Forms.

In the table below:

- Where only specific Uniform Registration Form disclosure questions are listed for an event, the mapping is to an affirmative response to any one of those disclosure questions.
- Where only relevant Disclosure Reporting Pages (DRP) fields are listed for an event, the mapping is to:
    - a selection of any of the listed DRP structured fields (i.e., checkbox fields); *or*
    - entry of relevant text (e.g., the sanctions listed in the definition of "specified risk event" and their equivalents) in a listed DRP unstructured field (i.e., free-text field).
- Where specific Uniform Registration Form disclosure questions *and* relevant DRP fields are listed for an event, the mapping is to an affirmative response to any one of the listed disclosure questions *and either:*
    - a selection of any of the listed DRP structured fields (i.e., checkbox fields); *or*
    - entry of relevant text (e.g., the sanctions listed in the definition of "specified risk event" and their equivalents) in a listed DRP unstructured field (i.e., free-text field).

Questions regarding this mapping guidance table should be directed to mappingguidance@finra.org.

This mapping guidance table may be updated periodically, as needed. FINRA will notify the membership of any such updates.

Mapping of Disclosure Categories for Final Criminal Matters and Specified Risk Events (Forms U4, U5, U6 and BD)

	Rule Subsection	Rule Text	Form U4 Question #	Form U5 Question #	Form U6* Question #	Form BD** Question #
Final Criminal Matters	1011(h)	The term "final criminal matter" means a criminal matter that resulted in a conviction of, or plea of guilty or nolo contendere ("no contest") by, a person that is disclosed, or is or was required to be disclosed, on the applicable Uniform Registration Forms.	14A(1)(a), 14A(2)(a), 14B(1)(a), 14B(2)(a)	7C(1), 7C(3)	• Criminal DRP 4B (Disposition of Charge): o Convicted, o Pled Guilty	11A(1), 11B(1)
Specified Risk Events:	1011(p)	The term "specified risk event" means any one of the following events that are disclosed, or are or were required to be disclosed, on an applicable Uniform Registration Form:				
1) Customer Awards (above de minimis threshold) in which individual was named[1]	1011(p)(1)	a final investment-related, consumer-initiated customer arbitration award or civil judgment against the person for a dollar amount at or above $15,000 in which the person was a named party;	14I(1)(b)[2]	7E(1)(b)[2]	• SRO Arbitration DRP 10A:[2] o Award	N/A[3]
2) Customer Settlements (above de minimis threshold) in which individual was named[1]	1011(p)(2)	a final investment-related, consumer-initiated customer arbitration settlement or civil litigation settlement for a dollar amount at or above $15,000 in which the person was a named party;	14I(1)(d)	7E(1)(d)	• SRO Arbitration DRP 10A:[4] o Settled	N/A[3]
3) Final Civil Judicial Actions with (A) monetary sanctions (above de minimis threshold), or (B) bars and suspensions[1]	1011(p)(3)	a final investment-related civil action where: (A) the total monetary sanctions (including civil and administrative penalties or fines, disgorgement, monetary penalties other than fines, or restitution) were ordered for a dollar amount at or above $15,000; or (B) the sanction against the person was a bar, expulsion, revocation or suspension;	14H(1)(a), 14H(1)(b) & • Civil Judicial DRP 12A: [5] o Civil and Administrative Penalty(ies)/Fine(s), o Disgorgement, o Monetary Penalty other than Fines, o Restitution • Civil Judicial DRP 12B[6]	N/A[7]	• Civil Judicial DRP 12A: [5] o Civil and Administrative Penalty(ies)/Fine(s), o Disgorgement, o Monetary Penalty other than Fines, o Restitution • Civil Judicial DRP 12B[6]	11H(1)(a), 11H(1)(b) & • Civil Judicial DRP Part II, 13A: o Disgorgement/Restitution, o Monetary/Fine o Bar, o Suspension, o Revocation/Expulsion/Denial • Civil Judicial DRP 13B[8]
4) Final Regulatory Action with (A) monetary sanctions (above de minimis threshold), or (B) bars and suspensions[1]	1011(p)(4)	a final regulatory action where (A) the total monetary sanctions (including civil and administrative penalties or fines, disgorgement, monetary penalties other than fines, or restitution) were ordered for a dollar amount at or above $15,000; or (B) the sanction against the person was a bar (permanently or temporarily), expulsion, rescission, revocation, or suspension from associating with a member.	14C, 14D, 14E & • Regulatory Action DRP 13A: [9] o Civil and Administrative Penalty(ies)/Fine(s), o Restitution, o Disgorgement, o Monetary Penalty other than Fines o Bar (Permanent), o Bar (Temporary/Time Limited), o Rescission, o Suspension, o Revocation, o Expulsion • Regulatory Action DRP 13C • Regulatory Action DRP 13B[10]	7D & • Regulatory Action DRP 12A: [9] o Civil and Administrative Penalty(ies)/Fine(s), o Restitution, o Disgorgement, o Monetary Penalty other than Fines o Bar (Permanent), o Bar (Temporary/Time Limited), o Rescission, o Suspension, o Revocation, o Expulsion • Regulatory Action DRP 12D • Regulatory Action DRP 12B[10]	• Regulatory Action DRP 13A: [9] o Civil and Administrative Penalty(ies)/Fine(s), o Restitution, o Disgorgement, o Monetary Penalty other than Fines o Bar (Permanent), o Bar (Temporary/Time Limited), o Rescission, o Suspension, o Revocation, o Expulsion • Regulatory Action DRP 13D • Regulatory Action DRP 13B[10]	11C, 11D, 11E & • Regulatory Action DRP Part II, 12A: o Disgorgement/Restitution, o Monetary/Fine o Bar, o Suspension, o Revocation/Expulsion/Denial • Regulatory Action DRP Part II, 12B[10]

Notes and Assumptions:

* The listed questions refer to the Form U6 for individuals (not firms).

** Includes questions associated with control affiliates.

[1] De minimis threshold is $15,000.

[2] Includes Customer Awards above de minimis threshold of $15,000. On Forms U4 and U5, Customer Award amounts are reported on Customer Complaint/Arbitration/Civil Litigation DRP 11A. On Form U6, Customer Award amounts are reported on SRO Arbitration DRP 10C.

[3] Form BD does not include information on Customer Awards or Customer Settlements.

[4] Includes Customer Settlements above de minimis threshold of $15,000. On Form U6, Customer Settlement amounts are reported on SRO Arbitration DRP 10C.

[5] Includes monetary sanctions associated with a Final Civil Judicial Action above de minimis threshold of $15,000. On Forms U4 and U6, these sanctions amounts are reported on Civil Judicial DRP 12D.

[6] The Civil Judicial DRP lists "Other Sanctions." The relevant sanctions are those listed in the Rule text, including Bar (permanent or temporary), Expulsion, Revocation or Suspension, and their equivalents.

[7] Form U5 does not include information on Civil Judicial Actions.

[8] The Civil Judicial DRP lists "Other Sanctions." The relevant sanctions are those listed in the Rule text and their equivalents.

[9] Includes monetary sanctions associated with a Final Regulatory Action above de minimis threshold of $15,000. On Form U4, these sanctions amounts are reported under Regulatory Action DRP 13E. On Form U5, these sanctions amounts are reported under Regulatory Action DRP 12F. On Form U6, these sanctions amounts are reported under Regulatory Action DRP 13F.

[10] The Regulatory Action DRP lists "Other Sanctions." The relevant sanctions are those listed in the Rule text and their equivalents.

Version 1- May 2021

Regulation Best Interest and Closing Remarks
Thursday, December 9
3:15 p.m. – 4:05 p.m.

Join FINRA staff as they discuss Regulation Best Interest – FINRA's approach and examination findings.

Moderator:
William St. Louis
Senior Vice President, Firm Group Leader
FINRA Member Supervision

Panelists:
Ted Luecke
Examination Manager – Denver Office
FINRA Member Supervision

Heidi Udagawa
Senior Principal Analyst, Risk Monitoring – Los Angeles Office
FINRA Member Supervision

Erin Vocke
Vice President, Firm Group Examinations – New Orleans Office
FINRA Member Supervision

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

Regulation Best Interest and Closing Remarks Panelist Bios:

Moderator:

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.

Panelists:

Ted Luecke is Examination Manager in FINRA's Denver Office and has worked at FINRA for nine years. In his current role, Mr. Luecke supervises examinations of member firms and registered representatives within FINRA's Retail firm grouping. Mr. Luecke graduated from the University of Missouri with an emphasis in Finance and Banking and Real Estate. He is a Certified Fraud Examiner (CFE).

Heidi Udagawa is Senior Principal Analyst, Risk Monitoring, in FINRA's Member Supervision department. In this capacity, she assesses business conduct, financial, operational, and trading risks and controls for firms in the Retail Independent Contractor firm grouping. She liaises internally with other FINRA departments with respect to examination strategy of the firms she is responsible for. In addition, she represents FINRA in interactions with firms. Ms. Udagawa's career at FINRA began in 1998. Prior to that, she worked in the operations and investment advisory departments at a member firm.

Erin C. Vocke is Vice President, Firm Group Examinations located in the New Orleans Office. Ms. Vocke began her career in 1995 as an examiner in the New Orleans District Office. During this time, she conducted routine and cause examinations of member firms and focused examinations in the areas of variable products and mutual funds. Ms. Vocke became Supervisor of Examiners and relocated to the Florida Office. She assumed responsibilities for supervising Continuing Membership Applications and financial surveillance of member firms, in addition to routine and cause examinations. Ms. Vocke was promoted to Associate District Director of the Dallas Office and assumed responsibility of overseeing the District cycle, cause, financial surveillance and Membership Application Programs. She served as the District Director of the Dallas District Office for approximately five years and the District Director for both the Dallas and New Orleans District Offices for approximately six years. In her new role, she will be responsible for examinations of retail member firms across Member Supervision.

Regulation Best Interest and Closing Remarks

Panelists

- **Moderator**
  - William St. Louis, Senior Vice President, Firm Group Leader, FINRA Member Supervision
- **Panelists**
  - Ted Luecke, Examination Manager – Denver Office, FINRA Member Supervision
  - Heidi Udagawa, Senior Principal Analyst, Risk Monitoring – Los Angeles Office, FINRA Member Supervision
  - Erin Vocke, Vice President, Firm Group Examinations – New Orleans Office, FINRA Member Supervision
- **Closing Speaker**
  - William St. Louis, Senior Vice President, Firm Group Leader, FINRA Member Supervision