Plenary Session I: Welcome Remarks
Monday, May 16, 2022
9:30 a.m. – 9:35 a.m.

Kayte Toczylowski opens the conference.

Speaker: Kayte Toczylowski
Vice President
FINRA Member Relations and Education

Plenary Session I: Welcome Remarks Speaker Bio:

Speaker:

Kayte Toczylowski is Vice President of Member Relations and Education for FINRA. In leading the Member Relations and Education Department, Ms. Toczylowski's responsibilities include maintaining and enhancing open and effective dialog with FINRA member firms. Ms. Toczylowski also oversees FINRA's Member Education area, which includes FINRA conferences and other member firm educational offerings such as the FINRA Institute at Georgetown for the Certified Regulatory and Compliance Professional (CRCP)® designation. Ms. Toczylowski has been with FINRA since 2011 and spent nine years in Member Supervision's examination program. Most recently, Ms. Toczylowski was an Examination Director located in the Philadelphia, PA office, where she led geographically dispersed exam teams responsible for planning and executing Member Supervision's examination program relative to a subset of firms engaged primarily in Capital Markets & Investment Banking Services. She entered the securities industry in 2003 in the compliance department of Janney Montgomery Scott, a regional broker-dealer headquartered in Philadelphia. The majority of her eight-year career at Janney was spent as a compliance examiner for the firm's branch network. Ms. Toczylowski has a Bachelor of Arts degree in English from Villanova.

Plenary Session I: Welcome Remarks

Speaker

- **Speaker**
  - Kayte Toczylowski, Vice President, FINRA Member Relations and Education

Plenary Session II: Fireside Chat With Robert Cook and Eileen Murray
Monday, May 16, 2022
9:35 a.m. – 10:00 a.m.

Join FINRA President and Chief Executive Officer Robert Cook and FINRA Chairperson Eileen Murray for a conversation on their perspectives on the state of the industry, future challenges, and the Board's priorities.

Speakers:

Robert Cook
President and Chief Executive Officer
FINRA

Eileen Murray
Former Co-CEO, Bridgewater Associates, LP
Chairperson and FINRA Public Governor

Plenary Session II: Fireside Chat With Robert Cook and Eileen Murray Speaker Bios:

Speakers:

Robert W. Cook is President and CEO of FINRA, and Chairman of the FINRA Investor Education Foundation. From 2010 to 2013, Mr. Cook served as the Director of the Division of Trading and Markets of the U.S. Securities and Exchange Commission. Under his direction, the Division's professionals were responsible for regulatory policy and oversight with respect to broker-dealers, securities exchanges and markets, clearing agencies and FINRA. In addition, the Division reviewed and acted on over 2,000 rule filings and new product listings each year from self-regulatory organizations, including the securities exchanges and FINRA, and was responsible for implementing more than 30 major rulemaking actions and studies generated by the Dodd-Frank and JOBS Acts. He also directed the staff's review of equity market structure. Immediately prior to joining FINRA, and before his service at the SEC, Mr. Cook was a partner based in the Washington, DC, office of an international law firm. His practice focused on the regulation of securities markets and market intermediaries, including securities firms, exchanges, alternative trading systems and clearing agencies. During his years of private practice, Mr. Cook worked extensively on broker-dealer regulation, advising large and small firms on a wide range of compliance matters. Mr. Cook earned his J.D. from Harvard Law School in 1992, a Master of Science in Industrial Relations and Personnel Management from the London School of Economics in 1989, and an A.B. in Social Studies from Harvard College in 1988.

Eileen Murray most recently served as Co-Chief Executive Officer of Bridgewater Associates, LP. Prior to joining Bridgewater, she was CEO for Investment Risk Management LLC and President and Co-CEO of Duff Capital Advisors. Ms. Murray launched her professional career in 1984 at Morgan Stanley, where she held several senior positions including Controller, Treasurer, and Global Head of Technology and Operations, as well as Chief Operating Officer for the firm's Institutional Securities Group. From 2002 to 2005, she was Head of Global Technology, Operations and Product Control at Credit Suisse and served on the firm's management and executive board. Ms. Murray is a non-executive Director at HSBC, Guardian Life Insurance Company of America and Atlas Crest Investment Corporation. She holds a bachelor's degree in accounting and an honorary doctorate degree from Manhattan College.

Plenary Session II: Fireside Chat With Robert Cook and Eileen Murray

Speakers

- **Speakers**
  - Robert Cook, President and Chief Executive Officer, FINRA
  - Eileen Murray, Former Co-CEO, Bridgewater Associates, LP, Chairperson and FINRA Public Governor

Plenary Session III: A Conversation With the Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission (SEC)
Monday, May 16, 2022
10:00 a.m. – 11:00 a.m.

Join FINRA President and CEO Robert Cook and SEC Chair Gary Gensler for a conversation about industry topics impacting the markets and the financial services industry.

Speakers:

Robert Cook
President and Chief Executive Officer
FINRA

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission (SEC)

Plenary Session III: A Conversation With the Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission (SEC) Speaker Bios:

Speakers:

Robert W. Cook is President and CEO of FINRA, and Chairman of the FINRA Investor Education Foundation. From 2010 to 2013, Mr. Cook served as the Director of the Division of Trading and Markets of the U.S. Securities and Exchange Commission. Under his direction, the Division's professionals were responsible for regulatory policy and oversight with respect to broker-dealers, securities exchanges and markets, clearing agencies and FINRA. In addition, the Division reviewed and acted on over 2,000 rule filings and new product listings each year from self-regulatory organizations, including the securities exchanges and FINRA, and was responsible for implementing more than 30 major rulemaking actions and studies generated by the Dodd-Frank and JOBS Acts. He also directed the staff's review of equity market structure. Immediately prior to joining FINRA, and before his service at the SEC, Mr. Cook was a partner based in the Washington, DC, office of an international law firm. His practice focused on the regulation of securities markets and market intermediaries, including securities firms, exchanges, alternative trading systems and clearing agencies. During his years of private practice, Mr. Cook worked extensively on broker-dealer regulation, advising large and small firms on a wide range of compliance matters. Mr. Cook earned his J.D. from Harvard Law School in 1992, a Master of Science in Industrial Relations and Personnel Management from the London School of Economics in 1989, and an A.B. in Social Studies from Harvard College in 1988.

Chair Gary Gensler was nominated by President Joseph R. Biden to Chair the U.S. Securities and Exchange Commission on February 3, 2021, confirmed by the U.S. Senate on April 14, 2021, and sworn into office on April 17, 2021. Before joining the SEC, Gensler was professor of the Practice of Global Economics and Management at the MIT Sloan School of Management, co-director of MIT's Fintech@CSAIL, and senior advisor to the MIT Media Lab Digital Currency Initiative. From 2017-2019, he served as chair of the Maryland Financial Consumer Protection Commission. Gensler was formerly chair of the U.S. Commodity Futures Trading Commission, leading the Obama Administration's reform of the $400 trillion swaps market. He also was senior advisor to U.S. Senator Paul Sarbanes in writing the Sarbanes-Oxley Act (2002), and was undersecretary of the Treasury for Domestic Finance and assistant secretary of the Treasury from 1997-2001. In recognition for his service, he was awarded the Alexander Hamilton Award, the U.S. Treasury's highest honor. He is a recipient of the 2014 Frankel Fiduciary Prize. Prior to his public service, Gensler worked at Goldman Sachs, where he became a partner in the Mergers & Acquisition department, headed the firm's Media Group, led fixed income & currency trading in Asia, and was co-head of Finance, responsible for the firm's worldwide Controllers and Treasury efforts. A native of Baltimore, Md., Gensler earned his undergraduate degree in economics in 1978 and his MBA from The Wharton School, University of Pennsylvania, in 1979. He has three daughters.

Plenary Session III: A Conversation With the Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission (SEC)

Speakers

- **Speakers**
  - Robert Cook, President and Chief Executive Officer, FINRA
  - The Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission (SEC)

Continuing Education Changes
Monday, May 16, 2022
11:15 a.m. – 12:15 p.m.

During this session, panelists discuss changes, and answer questions around the Securities Industry Continuing Education program.

Moderator:

Elisabeth Craig
Senior Vice President and Deputy
FINRA Credentialing, Registration, Education and Disclosure (CRED)

Panelists:

Bri Joiner
Director, Regulatory Compliance
Municipal Securities Rulemaking Board (MSRB)

Joseph McDonald
Senior Director, Qualifications & Exams
FINRA Credentialing, Registration, Education and Disclosure (CRED)

Patricia Monterosso
Director, CRED Continuing Education Services
FINRA Credentialing, Registration, Education and Disclosure (CRED)

James Papagiannis
Chief Compliance Officer
InspereX

Continuing Education Changes Panelists Bios:

Moderator:

Elisabeth Craig is Senior Vice President & Deputy, FINRA, Registration and Disclosure (RAD). In this role, Ms. Craig is responsible for oversight of RAD Registration, Testing and Continuing Education. Prior to joining FINRA, Ms. Craig was most recently employed as Counsel at DCS Advisory, an investment banking firm with multiple offices throughout the U.S. Ms. Craig focused on all aspects of legal and compliance matters impacting the firm, which is a registered broker dealer. Prior to joining DCS Advisory in November 2016, Ms. Craig spent over a decade at Legg Mason in Baltimore, Maryland, holding a number of senior positions in different departments, including in Corporate Legal, where she focused on public company reporting issues, corporate governance and worked directly with the company's independent board of directors; Global Compliance, where she was responsible for corporate compliance and regulatory affairs; and Regulatory Affairs, where she oversaw the regulatory affairs and licensing and registration departments of the company's former retail broker dealer subsidiary. Prior to Legg Mason, Ms. Craig worked for Allfirst Bank in Baltimore, Maryland, where she served as the Chief Compliance Officer and Brokerage Counsel. Before working in-house, Ms. Craig worked in private practice in the Baltimore office of Saul Ewing, LLP, where she was an associate in the securities litigation group. Ms. Craig received her Juris Doctor degree with honors from the University of Maryland School of Law and a Bachelor of Arts degree with honors from Skidmore College.

Panelists:

Bri Joiner is Director of Regulatory Compliance at the Municipal Securities Rulemaking Board (MSRB), in which she oversees a portfolio of programs under the MSRB's Market Regulation department, maintaining responsibility for strategic planning and execution of long-term objectives. Ms. Joiner is directly responsible for the MSRB's professional qualifications program, examiner training program and regulatory compliance program initiatives. Prior to assuming her current role, Ms. Joiner managed the MSRB's regulatory education program leading the development and delivery of content for regulated entities and market stakeholders in support of a fair and efficient municipal securities market. Prior to joining the MSRB, Ms. Joiner spent 10 years at the Financial Industry Regulatory Authority (FINRA). She served as Senior Regulatory Policy Analyst in FINRA's Office of General Counsel, where she worked on rulemaking initiatives and researched legal and compliance matters. She also held the position of Senior Manager in FINRA's Member Education and Training department, where she advised on initiatives having a market impact and served as a subject matter expert on various topics. Ms. Joiner began her career at the U.S. Securities and Exchange Commission. Ms. Joiner earned a bachelor's degree, *magna cum laude*, from Spelman College and a juris doctor from the Walter F. George School of Law, Mercer University. She is a member of Phi Beta Kappa Honor Society, Golden Key International Honour Society and Phi Delta Phi Legal Fraternity.

Joe McDonald is Senior Director in FINRA's Testing and Continuing Education Department, where he manages the FINRA qualification examination and examination waivers programs. Previously, he was a director in FINRA's Market Regulation Department. Mr. McDonald has been with FINRA for 24 years. Before joining FINRA, he worked as counsel in the Office of Compliance and Inspections and the Division of Market Regulation at the Securities and Exchange Commission, and as a clerk for an administrative law judge at the Commodity Futures Trading Commission. Mr. McDonald received a bachelor's degree in psychology from the State University of New York at Stony Brook and a law degree from the American University's Washington College of Law.

Patricia Monterosso is Director of CRED Continuing Education Services at FINRA, where she is responsible for overall management of the Securities Industry Continuing Education program, including the development and maintenance of content for the Regulatory Element program, the Maintaining Qualifications Program (MQP) and FINRA's SRO-client programs. She is also responsible for overseeing the creation of Firm Element advice and content. Ms. Monterosso has more than 16 years of combined regulatory experience at FINRA and NYSE. During this time, she held different roles in testing and continuing education, including those in which she has been responsible for co-managing the development and maintenance of qualification exams and overseeing waivers processing. Prior to working at a regulator, Ms. Monterosso served in compliance, supervisory and registered principal roles at several different broker-dealer firms. Ms. Monterosso received a B.A. in Economics from Barnard College, Columbia University. She also received an MBA with a dual concentration in Finance and Management Systems from the Gabelli School of Business at Fordham University.

James J. Papagiannis is Chief Compliance Officer of InspereX, a fintech company, which is engaged in institutional sales and trading of U.S. government agencies, municipal bonds, certificates of deposit, corporate bonds, preferred stock and mortgage-backed securities, as well as the wholesale distribution of new issue, retail financial instruments including InterNotes®, CDs, and structured notes. InspereX, through its technology company, offers BondNav®, a market-leading fixed income technology platform that displays a wide array of new issue and secondary market fixed income offerings. In this role, Mr. Papagiannis is responsible for overseeing and directing the regulatory compliance program of InspereX and its affiliates. Prior to joining InspereX, Mr. Papagiannis spent 14 years at the Financial Industry Regulatory Authority ("FINRA") where he served as Examination Manager in nearly every area of FINRA's Member Regulation Division, including member firm cycle examinations, targeted cause examinations, financial/operational reviews, and membership applications. While at FINRA, Mr. Papagiannis examined several hundred broker-dealers with various business lines and has a great perspective on a wide range of securities regulations and compliance considerations. Mr. Papagiannis obtained a B.S. in finance and an MBA in international finance and marketing from DePaul University. Mr. Papagiannis holds the Chartered Financial Analyst (CFA) designation. Mr. Papagiannis currently serves as Chairman of the Securities Industry/Regulatory Council on Continuing Education (CE Council). Mr. Papagiannis also serves on the Board of Directors of the National Society of Compliance Professionals (NSCP) and is a member of the Strategic Planning Committee.

Continuing Education Changes

Panelists

- **Moderator**
  - Elisabeth Craig, Senior Vice President and Deputy, FINRA Credentialing, Registration, Education and Disclosure (CRED)
- **Panelists**
  - Bri Joiner, Director, Regulatory Compliance, Municipal Securities Rulemaking Board (MSRB)
  - Joseph McDonald, Senior Director, Qualifications & Exams, FINRA Credentialing, Registration, Education and Disclosure (CRED)
  - Patricia Monterosso, Director, CRED Continuing Education Services, FINRA Credentialing, Registration, Education and Disclosure (CRED)
  - James Papagiannis, Chief Compliance Officer, InspereX

Agenda

01 | CE Council

02 | CE Transformation Overview

03 | Maintaining Qualifications Program (MQP)

04 | Regulatory Element and Firm Element Changes

05 | Resources and How to Prepare

06 | Q&A

About CE Council

- Holds advisory and consultative responsibilities regarding the development, implementation and ongoing operation of the Continuing Education Program.

- Composed of industry members and self-regulatory organization (SRO) members (*i.e.*, Cboe, FINRA, MEMX, MIAX, MSRB, NYSE).

- Works with liaisons from the SEC and NASAA.

CE Transformation – Overall Goals

- Provide more timely and relevant training on significant regulatory matters.
- Improve coordination between Regulatory Element and Firm Element programs.
- Improve Firm Element guidance, resources and access to content.
- Extend ability to maintain qualifications while away from the industry.

Maintaining Qualifications Program (MQP)

- The MQP officially launched on March 15, 2022.
- The MQP allows for individuals to maintain their qualifications after termination of their registrations for up to five years.
- Content is specific to the registration category for which an individual wants to maintain their qualification.
- Annual CE Program consists of Regulatory Element content and Practical Element content.

Regulatory Element Changes *(1/1/23 rule changes)*

- The Regulatory Element has an Annual requirement with a December 31 deadline.
- Content will be registration-targeted and include timely education on regulatory matters (*e.g.*, rule changes, industry hot topics).
- Regulatory Element learning topics will be published in advance of each coming year to assist firms in planning their Firm Element programs.
- FINRA systems functionality will be enhanced to facilitate compliance with the Regulatory Element requirements (*e.g.*, tracking, notifications, reporting capabilities).

Firm Element Changes *(1/1/23 rule changes)*

- Improve guidance and resources provided to firms for conducting the Firm Element annual needs analysis and training program.
- Extend Firm Element training to all registered persons.
- Recognize other training requirements for purposes of satisfying Firm Element (*e.g.*, annual compliance training, anti-money laundering compliance training).
- Create a centralized content catalog to include content created by SROs and training providers that firms may optionally leverage for their firm training.

CE Transformation – How Firms Can Prepare

- Onboard representatives to Financial Professional Gateway (FinPro).
- Ensure firm CE contact information in the FINRA Contact System (FCS) is accurate.
- Subscribe to the Registration & Testing Information email list for updates.

CE Transformation – Informational Resources

CE Transformation Resources

- FINRA *Regulatory Notice 21-41* and FAQ
- MQP page: *www.finra.org/mqp*
- CE Transformation Page: *www.finra.org/cet*

CE Council Resources

- CE Council Website: *www.cecouncil.org*
- Firm Element Guidance
- Firm Element FAQ

Continuing Education Changes
Monday, May 16, 2022
11:15 a.m. – 12:15 p.m.

Resources:

FINRA Resources:

- FINRA *Regulatory Notice 21-41, FINRA Amends Rules 1210 and 1240 to Enhance the Continuing Education Program for Securities Industry Professionals* (November 2021)

  www.finra.org/rules-guidance/notices/21-41

- Frequently Asked Questions Related to FINRA *Regulatory Notice 21-41*

  www.finra.org/registration-exams-ce/continuing-education/ce-transformation-faq

- The Maintaining Qualifications Program (MQP)

  www.finra.org/mqp

- Securities Industry CE Transformation

  www.finra.org/cet

CE Council Resources:

- CE Council Website

  www.cecouncil.org

- CE Council Guide to Continuing Education Firm Element Programs

  www.cecouncil.org/media/266855/ce-council-guide-to-firm-element-ce-programs.pdf

- CE Council Firm Element Frequently Asked Questions

  www.cecouncil.org/media/266856/ce-council-website-firm-element-faqs.pdf

Left of Boom: Fraud Prevention Solutions
Monday, May 16, 2022
11:15 a.m. – 12:15 p.m.

Join FINRA staff and industry experts as they discuss "left of boom". This means identifying the threat and preventing a disruption before an attack should occur. Panelists share effective left and right of boom policies and procedures.

Moderator:

Jamie Udinson
Senior Director, Strategic Alliances
FINRA Member Supervision

Panelists:

Jason Foye
Senior Director, Special Investigations Unit
FINRA Member Supervision

Ivy Gong
Global Head of Fraud Operations
Morgan Stanley

Kara Suro
Managing Director, Head of Fraud Risk Management
Charles Schwab & Co., Inc.

Tina Tambiah
Senior Director, Initial Review Group
FINRA Member Supervision

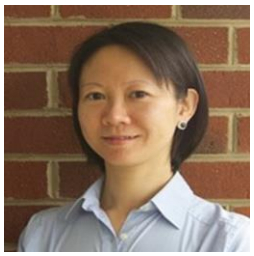
Left of Boom: Fraud Prevention Solutions Panelists Bios:

Moderator:

Jamie Udinson is Senior Director, Strategic Alliances in the Office of Member Supervision at FINRA, where she provides expert advice to the executive management team of Member Supervision, including the Executive Vice President of Member Supervision, on a full range of operational, policy and regulatory issues, and their associated communications. Ms. Udinson is responsible for strategic initiatives across Member Supervision's many groups, including Firm Exams, Risk Monitoring, the Member Application Program, and National Cause and Financial Crimes Detection Programs. During her 14 years at FINRA, Ms. Udinson has served in both the Member Supervision and Enforcement Departments, and most recently as the Chief of Staff to the Executive Vice President of National Cause and Financial Crimes Detection Program. Ms. Udinson has an MBA from La Salle University and is a Certified Anti-Money Laundering Specialist.

Panelists:

Jason Foye is Director of FINRA's AML Investigative Unit, a specialized team that conducts complex Anti-Money Laundering examinations, provides guidance to FINRA's examination and Enforcement staff in connection with AML-related matters, and provides education and training to FINRA staff and industry personnel throughout the country. Mr. Foye serves as an AML Regulatory Specialist within FINRA and is Certified Anti-Money Laundering Specialist and a Certified Fraud Examiner. Mr. Foye graduated from Florida State University with a Bachelor's degrees in Finance and Risk Management. Mr. Foye works from FINRA's Florida District Office, and has been with FINRA for 11 years.



Ivy Gong is the Global Head of Fraud Operations under Technology and Operations Risk Division at Morgan Stanley. In her current role, Ms. Gong is responsible for first-line fraud risk management for the firm, including fraud policy, strategy, analytics, investigation, and cyber fraud security awareness education. She also facilitates closer alignment of fraud and cyber synergy. Ms. Gong is based in Morgan Stanley Baltimore office. She joined the Global Fraud Operations in 2016 at the initial stage of the Fraud Operations function built out. Prior to Morgan Stanley, Ms. Gong has 15 plus years' experience in various risk management roles with retail banking, credit card, and management consulting.

Kara Suro is Managing Director and Head of Fraud Risk Management responsible for governance and implementation of Schwab's Fraud Risk Management Program, including orchestration of firm-wide fraud strategy prevention, detection, response, and reporting elements. In this role, Ms. Suro also oversees the surveillance and investigations teams responsible for providing enterprise-wide coverage relating to financial and cyber fraud against clients as well as fraud and regulatory violations associated with Registered Investment Advisors (RIAs) using Schwab's Advisor Services platform. Prior to returning to Schwab in her current capacity in 2015, Ms. Suro was a Director with Schwab's Compliance Regulatory Group from 2011 to 2012. Ms. Suro has a JD and was previously a securities attorney with Bingham McCutchen.

Tina Tambiah is Senior Director in the National Cause and Financial Crimes Detection Programs. In this role, she oversees FINRA's centralized intake unit responsible for reviewing and investigating regulatory events, including investor complaints and regulatory tips. Prior to this role, Ms. Tambiah was an Investigations Director in the Retail Firm Grouping. She led a team managing large and complex investigations which included fraudulent activity and other serious misconduct. Prior to 2019, Ms. Tambiah held management roles in the Firm Exam and Cause programs while in the Boston District Office where she was responsible for managing routine and specialized examinations of member broker-dealers and investigations of

customer complaints, termination for cause, disclosure filings and regulatory tips against individual brokers. She has presented case findings and disciplinary action recommendations to the enforcement department for disciplinary action proceedings. Ms. Tambiah earned her Bachelor of Arts degree in Economics from Stony Brook University.

Left of Boom: Fraud Prevention Solutions

Panelists

- **Moderator**
  - Jamie Udinson, Senior Director, Strategic Alliances, FINRA Member Supervision
- **Panelists**
  - Jason Foye, Senior Director, Special Investigations Unit, FINRA Member Supervision
  - Ivy Gong, Global Head of Fraud Operations, Morgan Stanley
  - Kara Suro, Managing Director, Head of Fraud Risk Management, Charles Schwab & Co., Inc.
  - Tina Tambiah, Senior Director, Initial Review Group, FINRA Member Supervision

FEBRUARY 2022

2022 Report on FINRA's Examination and Risk Monitoring Program

Introduction

The 2022 Report on FINRA's Examination and Risk Monitoring Program (the Report) provides firms with information that may help inform their compliance programs. For each topical area covered, the Report identifies the relevant rule(s), highlights key considerations for member firms' compliance programs[1], summarizes noteworthy findings from recent examinations, outlines effective practices that FINRA observed during its oversight, and provides additional resources that may be helpful to member firms in reviewing their supervisory procedures and controls and fulfilling their compliance obligations.

FINRA's intent is that the Report be an up-to-date, evolving resource or library of information for firms. To that end, the Report builds on the structure and content in the 2021 Report by adding new topics (*e.g.,* Disclosure of Order Routing Information, Funding Portals) denoted **NEW FOR 2022** and new material (*e.g.,* new exam findings, effective practices) to existing sections where appropriate. (New material in existing sections is in **bold** type.) In addition, those general findings that are also particularly relevant for firms in their first year of operation are denoted with a star (★).

As always, FINRA welcomes feedback on how we can improve future publications of this Report. Please contact Steve Polansky, Senior Director, Member Supervision at (202) 728-8331 or by email; or Rory Hatfield, Associate Principal Research Analyst, Member Supervision at (240) 386-5487 or by email.

Selected Highlights

In 2021, considerable industry, and in some cases public, attention was focused on topics that FINRA also addressed through its exam and risk monitoring program. These topics include newer SEC Rules (*e.g.,* Regulation Best Interest (Reg BI), Form CRS, amendments to Rule 606), recent increases in the number and sophistication of cybersecurity threats, and the proliferation of securities trading through mobile apps.

Reg BI and Form CRS

During Reg BI's and Form CRS' first full calendar year of implementation in 2021, FINRA expanded the scope of its reviews and testing relative to 2020 to execute a more comprehensive review of firms' processes, practices and conduct in areas such as establishing and enforcing adequate written supervisory procedures (WSPs); filing, delivering and tracking accurate Forms CRS; making

recommendations that adhere with Reg BI's Care Obligation; identifying and mitigating conflicts of interest; and providing effective training to staff. In this Report, FINRA notes its initial findings from its Reg BI and Form CRS reviews during the past year and will share additional findings at a future date.

CAT

FINRA continues to evaluate member firms that receive or originate orders in National Market System (NMS) stocks, over-the-counter (OTC) equity securities and listed options for compliance with Securities Exchange Act of 1934 (Exchange Act) Rule 613 and the CAT NMS Plan FINRA Rule 6800 Series (Consolidated Audit Trail Compliance Rule) (collectively, CAT Rules). This year's Report addresses compliance with certain CAT obligations, such as reporting CAT information to the Central Repository and maintaining an effective supervision process (including clock synchronization performed by third-party vendors).

Order Handling, Best Execution and Conflicts of Interest

Assessing firms' compliance with their best execution obligations under FINRA Rule 5310 (Best Execution and Interpositioning) is one of the cornerstones of FINRA's oversight activities. This oversight has evolved with changes in firms' business models, for example the advent of the "zero commission" model.

As noted in last year's Report, FINRA launched a targeted exam to "evaluate the impact that not charging commissions has or will have on the member firms' order-routing practices and decisions, and other aspects of member firms' business." FINRA will share its findings with member firms at a future date.

In addition, FINRA is focusing on firms' compliance with Rule 606 of Regulation NMS, which requires broker-dealers to disclose information regarding the handling of their customers' orders in NMS stocks and listed options. This information provides transparency to customers and can help them: better understand how their firm routes and handles their orders; assess the quality of order handling services provided by their firm; and determine whether their firm is effectively managing potential conflicts of interest that may impact their firm's routing decisions.

Mobile Apps

Advances in technology and its application continue to reshape the way some firms attract and interact with customers on mobile apps. These innovations can benefit investors in several ways, including increasing their market participation, expanding the types of products available to them and educating them on financial concepts. At the same time, however, these apps raise novel questions and potential concerns, such as whether they encourage retail investors to engage in trading activities and strategies that may not be consistent with their investment goals or risk tolerance, and how the apps' interface designs could influence investor behavior.

FINRA has identified significant problems with some mobile apps' communications with customers and firms' supervision of activity on those apps (particularly controls around account openings). FINRA has also observed mobile apps making use of social media to acquire customers, and recently initiated a targeted exam to assess firms' practices in this area, including with respect to firms' management of their obligations related to information collected from those customers and other individuals who may provide data to firms; FINRA will share its findings from this review after its completion.

Special Purpose Acquisition Companies (SPACs)

Another topic that has received significant attention is the increased use of Special Purpose Acquisition Companies (SPACs) to bring companies public. For example, in 2019, approximately 25 percent of initial public offerings were accomplished through SPACs; in the first quarter of 2021, this figure was over 70 percent.

FINRA recognizes how SPACs can provide companies with access to diverse funding mechanisms and allow investors to access new investment opportunities; however, as SPAC activity has increased, so too has FINRA's focus on broker-dealers' compliance with their regulatory obligations in executing SPAC transactions. In October 2021, FINRA launched a targeted exam to explore a range of issues, including how firms manage potential conflicts of interest in SPACs, whether firms are performing adequate due diligence on merger targets and if firms are providing adequate disclosures to customers. At a future date, FINRA will share with member firms its findings from this review.

Cybersecurity

Cybersecurity threats are one of the primary risks firms and their customers face. Over the past year, FINRA has continued to observe increases in the number and sophistication of these threats. For example, in 2021, FINRA has alerted firms about phishing campaigns involving fraudulent emails purporting to be from FINRA, as well as new customers opening online brokerage accounts to engage in Automated Clearing House (ACH) "instant funds" abuse. FINRA has issued additional regulatory guidance concerning the increase of bad actors using compromised registered representative or employee email accounts to execute transactions or move money; using customer information to gain unauthorized entry to customers' email accounts, online brokerage accounts or both (*i.e.,* customer account takeover (ATO) incidents); and using synthetic identities to fraudulently open new accounts. FINRA will continue to assess firms' programs to protect sensitive customer and firm information, as well as share effective practices firms can employ to protect their customers and themselves. Where appropriate, FINRA will also share information about cybersecurity threats to firms.

Complex Products

FINRA will continue to review firms' communications and disclosures made to customers in relation to complex products, and will review customer account activity to assess whether firms' recommendations regarding these products are in the best interest of the retail customer given their investment profile and the potential risks, rewards and costs associated with the recommendation. In addition, in August of last year, FINRA launched a targeted exam to review members' practices and controls related to the opening of options accounts which, in some instances, may be used to engage in complex strategies involving multiple options (such as spreads). FINRA will share its findings from this review at a future date.

How to Use This 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 program 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.

- **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 prior Reports and that we 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.

- **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 (*e.g.,* Exam Findings Reports, 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 that extend beyond the requirements of existing federal securities provisions or FINRA rules.

Firm Operations

Anti-Money Laundering

Regulatory Obligations and Related Considerations

Regulatory Obligations:

The Bank Secrecy Act (BSA) and implementing regulations form the foundation for member firms' Anti-Money Laundering (AML) obligations. (The BSA has been amended several times, including by the USA PATRIOT ACT of 2001 and the Anti-Money Laundering Act of 2020.) **The implementing regulations impose a number of requirements on broker-dealers, which include implementing and maintaining both AML programs and Customer Identification Programs (CIPs); filing reports of suspicious activity; verifying the identity of legal entity customers; maintaining procedures for conducting ongoing customer due diligence; establishing due diligence programs to assess the money laundering risk presented by correspondent accounts maintained for foreign financial institutions; and responding to information requests from the Financial Crimes Enforcement Network (FinCEN) within specified timeframes.**

FINRA Rule 3310 (Anti-Money Laundering Compliance Program) requires that members develop and implement a written AML program reasonably designed to comply with the requirements of the BSA and its implementing regulations. **FINRA Rule 3310 also requires FINRA member firms to, among other things, establish and implement policies, procedures and internal controls that can be reasonably expected to detect and cause the reporting of suspicious activity; provide for an independent test of the AML program each calendar year (or every two years in some specialized cases); and provide ongoing training for appropriate personnel.**

Related Considerations:

- Does your firm's AML program reasonably address your business model, new and existing business lines, products, customers, geographic locations and associated AML risks?
- **Has your firm experienced substantial growth or changes to its business? If so, has its AML program reasonably grown and evolved alongside the business?**
- **Do your firm's AML procedures recognize that the suspicious activity reporting obligation may apply to any transactions conducted by, at or through the firm, even transactions that do not originate with your firm's customers?**
- **Does your firm have appropriately designed AML procedures to identify and respond to known indicators of suspicious activity involving low-priced securities, such as those detailed in FINRA *Regulatory Notices* *19-18* and *21-03*?**
- Does your firm's independent AML testing confirm that it maintains and implements reasonably designed procedures for suspicious activity detection and reporting?
- Does your firm collect identifying information and verify the identity of all individuals and entities that would be considered customers under the CIP Rule, and beneficial owners of legal entity customers under the Customer Due Diligence (CDD) Rule?
- **If your firm uses automated surveillance systems for suspicious activity monitoring, does your firm review the integrity of its data feeds and assess scenario parameters as needed?**
- If your firm introduces customers and activity to a clearing firm, how does your firm coordinate with your clearing firm, including with respect to the filing of Suspicious Activity Reports (SARs)?

- **Has your firm established and implemented appropriate procedures to: communicate cyber events to its AML department, Compliance department or both; fulfill regulatory obligations, such as the filing of SARs; and inform reviews of potentially impacted customer accounts?**
- **Has your firm reviewed FinCEN's first government-wide priorities for AML and countering the financing of terrorism (AML/CFT) policy ("AML/CFT Priorities"), and considered how the AML/CFT Priorities will be incorporated into its risk-based AML program?**

Emerging Low-Priced Securities Risk

FINRA has observed an increase in several types of activity in low-priced securities that could be indicative of fraud schemes—including an increase in such activity through foreign financial institutions (FFIs) that open omnibus accounts at U.S. broker-dealers. Recent trends indicate that FFIs may be "nesting"[2] within omnibus accounts of financial institutions based in jurisdictions that are generally considered to be lower risk, such as Canada or the United Kingdom.

To assist member firms in detecting and preventing these schemes—as well as mitigating the harm they cause to investors and the market—FINRA is sharing some of the signs of potentially illicit trading activity in low-priced securities that it has recently observed, which include:

- trading that coincides with a sudden increase in share price or trading volume, in the absence of legitimate news surrounding the company;
- investors depositing large blocks of shares of low-priced securities originating from convertible debt acquired from the issuer or a third party, immediately selling the shares and then transferring the proceeds out of the account;
- transactions in securities of issuers making questionable claims regarding their products or services related to a recent, major event (*e.g.,* the COVID-19 pandemic) or a new trend (*e.g.,* cryptocurrency or non-fungible tokens (NFTs)) or both; and
- increased trading that overlaps with a surge in relevant promotional activity on social media, investor chat rooms and message boards.

Firms can find additional resources concerning potential warning signs of fraudulent activity:

- FINRA's Investor Alerts and Investor Insights webpages
- *Regulatory Notice 21-03* (FINRA Urges Firms to Review Their Policies and Procedures Relating to Red Flags of Potential Securities Fraud Involving Low-Priced Securities)
- *Regulatory Notice 19-18* (FINRA Provides Guidance to Firms Regarding Suspicious Activity Monitoring and Reporting Obligations)
- SEC's Staff Bulletin: Risks Associated with Omnibus Accounts Transacting in Low-Priced Securities
- SEC's Risk Alert on Compliance Issues Related to Suspicious Activity Monitoring and Reporting at Broker-Dealers

Exam Findings and Effective Practices

Exam Findings:

- **Inadequate Ongoing Monitoring and Reporting of Suspicious Transactions – Failing to establish and implement an AML program reasonably expected to detect and report suspicious activity in compliance with FINRA Rule 3310(a) by, for example:**
  - **not using AML reports or systems that accurately and reasonably capture potentially suspicious activity, and are free of data integrity issues;**
  - **not conducting and accurately documenting AML surveillance reviews;**
  - **not implementing appropriate risk-based procedures to understand the nature and purpose of customer relationships in order to develop a customer risk profile;**
  - **not implementing procedures that are reasonably designed to investigate inquiries from clearing firms that concern "red flags" of potentially suspicious activity;**
  - **not tailoring AML programs to risks presented by products, customers, business lines and transactions (*e.g.,* cash management products, low-priced securities trading) and wire and ACH transfers; and**
  - **not notifying AML departments of events that involve suspicious transactions (*e.g.,* cybersecurity events, account compromises or takeovers, new account fraud, fraudulent wires and ACH transfers).**
- **Inadequate AML Independent Tests – Failing to comply with FINRA Rule 3310(c) by conducting AML tests that fail to review key aspects of the AML program, are not performed within the required timeframe, are not completed by persons with the requisite independence or are not completed at all.**
- **Insufficient Compliance With Certain Requirements of the BSA – Failing to establish a risk-based CIP to verify the identity of each customer in compliance with FINRA Rule 3310(b), failing to verify the identity of the beneficial owners of legal entity customers in compliance with FINRA Rule 3310(f) or failing to conduct due diligence on correspondent accounts of foreign financial institutions in compliance with FINRA Rule 3310(b).**

Update on Initial Public Offerings (IPOs) of China-Based Issuers

FINRA has observed that some firms are underwriting IPOs and subsequent trading of issuers based in the People's Republic of China (China-based issuers), raising concerns that the investors in the IPOs may be serving as nominees for an undisclosed control person or persons. These IPOs are typically smaller in size (*i.e.,* less than $100 million) and listed on the lower qualification tiers of U.S. stock exchanges.

FINRA has observed red flags of potentially manipulative trading associated with how these investors open new accounts and trade these securities after the IPO is completed, including:

- numerous unrelated accounts being opened at the same time, including with similar banking information, physical addresses, email address domains and current employer (which is often associated with the IPO issuer);
- documents investors provide in order to open an account or verify source of funds that may have been altered or could be fictitious;
- wire transfers received into these accounts that exceed the financial wherewithal of the investor as indicated on their new account documents, exceed the value of the shares purchased in the IPO and are either sent from similar banks, or bank accounts that share certain identifying information (*e.g.,* employer of account holder, email domain);
- investor accounts being accessed by a different Internet Protocol (IP) or Media Access Control (MAC) address[3] than is known for the customer, granting log in and trading capabilities to a third party or both;
- multiple orders with substantial similar terms being placed at or around the same time by seemingly unrelated investors in the same security that is indicative of "spoofing" or "layering"; and
- investors engaging in trading activity that does not make economic sense.

Given the potential risks, firms underwriting these IPOs and whose customers trade in these securities after the IPO should carefully evaluate whether they have controls in place necessary to identify and report market manipulation, other abusive trading practices and potential AML concerns. Firms can find additional information regarding the risks associated with China-based issuers in recent statements from the SEC:

- Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited
- Disclosure Considerations for China-Based Issuers
- [Chairman Gensler's] Statement on Investor Protection Related to Recent Developments in China

Effective Practices:

- **Risk Assessments** – Conducting an initial, formal written risk assessment and updating it based on the results of AML tests, audits and changes in size or risk profile of the firm (*e.g.,* business lines, products and services, registered representatives and customers).
- **Verifying Customers' Identities When Establishing Online Accounts – In meeting their CIP obligations, validating identifying information or documents provided by applicants (*e.g.,* Social Security number (SSN), address, driver's license), including, for example, through "likeness checks"; asking follow-up questions or requesting additional documents based on information from credit bureaus and credit reporting agencies, or digital identity intelligence (*e.g.,* automobile and home purchases); contracting third-party vendors to provide additional support (*e.g.,* databases to help verify the legitimacy of suspicious information in customers' applications); limiting automated approval of multiple accounts**

by a single customer; reviewing account applications for repetition or commonalities amongst multiple applications; and using technology to detect indicators of automated scripted attacks.[4]

- **Delegation and Communication of AML Responsibilities – When AML programs rely on other business units to escalate red flags of suspicious activity, establishing clearly delineated written escalation procedures and recurring cross-department communication with AML and compliance staff.**
- **Training – In meeting their obligations to provide ongoing AML training for appropriate personnel under FINRA Rule 3310(e), establishing and maintaining AML training programs that are tailored for the respective roles and responsibilities of the AML department, as well as departments that regularly work with AML; that address regulatory and industry developments impacting AML risk or regulatory requirements; and that, where applicable, leverage trends and findings from quality assurance controls.**
- **Detection and Mitigation of Wire and ACH Fraud** – In meeting their obligations to conduct ongoing monitoring to identify and report suspicious transactions under FINRA Rule 3310(f), monitoring outbound money movement requests post-ACH setup and restricting fund transfers in certain situations (*e.g.,* identity theft is detected in an investor's account).[5]

Additional Resources

- SEC
  - **Risk Alert: Compliance Issues Related to Suspicious Activity Monitoring and Reporting**
  - **Staff Bulletin: Risks Associated with Omnibus Accounts Transacting in Low-Priced Securities**
- FinCEN
  - **Advisory on Cybercrime and Cyber-Enabled Crime Exploiting the Coronavirus Disease 2019 (COVID-19) Pandemic**
  - **Advisory on Cyber-Events and Cyber-Enabled Crime**
  - **Advisory on Ransomware and the Use of the Financial System to Facilitate Ransom Payments**
  - **Anti-Money Laundering and Countering the Financing of Terrorism National Priorities**
  - **Frequently Asked Questions (FAQs) regarding the Reporting of Cyber-Events, Cyber-Enabled Crime, and Cyber-Related Information through Suspicious Activity Reports (SARs)**
- FINRA
  - Anti-Money Laundering (AML) Topic Page, which includes:
    - Anti-Money Laundering (AML) Template for Small Firms
    - ***Regulatory Notice 21-36* (FINRA Encourages Firms to Consider How to Incorporate the Government-wide Anti-Money Laundering and Countering the Financing of Terrorism Priorities Into Their AML Programs)**
    - ***Regulatory Notice 21-18* (FINRA Shares Practices Firms Use to Protect Customers from Online Account Takeover Attempts)**
    - ***Regulatory Notice 21-03* (FINRA Urges Firms to Review Their Policies and Procedures Relating to Red Flags of Potential Securities Fraud Involving Low-Priced Securities)**
    - ***Regulatory Notice 20-32* (FINRA Reminds Firms to Be Aware of Fraudulent Options Trading in Connection with Potential Account Takeovers and New Account Fraud)**
    - *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)

FinCEN National AML/CFT Priorities

As noted in *Regulatory Notice* 21-36, on June 30, 2021, FinCEN issued the AML/CFT Priorities, which identify and describe the most significant AML/CFT threats currently facing the United States (*e.g.,* cybercrime, domestic and international terrorist financing, securities and investment fraud).

The publication of the AML/CFT Priorities does not create an immediate change in BSA requirements or supervisory expectations for member firms, and FINRA is not currently examining for the incorporation of the AML/CFT Priorities into member firms' AML programs. Nevertheless, in preparation for any new requirements when the final regulations are effective, broker-dealers may wish to start considering how they will incorporate the AML/CFT Priorities into their risk-based AML programs.

Cybersecurity and Technology Governance

Regulatory Obligations and Related Considerations

Regulatory Obligations:

Rule 30 of the SEC's Regulation S-P 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 or issues related to an increase in trading volumes, can expose firms to operational failures that may compromise firms' ability to comply with a range of rules and regulations, including FINRA Rules 4370, 3110 (Supervision) and 4511 (General Requirements), as well as Securities Exchange Act of 1934 (Exchange Act) Rules 17a-3 and 17a-4.

Related Considerations:

Cybersecurity

- **What is the firm's process for continuously assessing cybersecurity and technology risk?**
- What kind of governance processes 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 and scanning of outbound emails to identify sensitive information?
- How does your firm identify and 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?
- **What types of penetration ("PEN") testing, if any, does your firm do to test web-facing systems that allow access to customer information or trading?**
- **How does your firm monitor for imposter websites that may be impersonating your firm or your registered representatives? How does your firm address imposter websites once they are identified?**
- **What are your firm's procedures to communicate cyber events to AML or compliance staff related to meeting regulatory obligations, such as the filing of SARs and informing reviews of potentially impacted customer accounts?**

Cybercrime

- FINRA continues to observe fraudsters and other bad actors engaging in cybercrime that increases both fraud risk (*e.g.,* synthetic identity theft, customer account takeovers, illegal transfers of funds, phishing campaigns, imposter websites) and money laundering risk (*e.g.,* laundering illicit proceeds through the financial system).
- Events involving, or enabled by, cybercrime are expected to be reported via SARs. FINRA has also published *Regulatory Notice* 21-18 (FINRA Shares Practices Firms Use to Protect Customers From Online Account Takeover Attempts), which discusses cybersecurity practices firms may find effective in mitigating risks related to ATOs and funds transfers.

Technology Governance

- 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 system or application 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 Findings and Effective Practices

Exam Findings:

- **Inadequate Risk Assessment Process – Not having an adequate and ongoing process to assess cyber and IT risks at the firm, including, for example, failing to test implemented controls or conducting PEN testing regularly.**
- **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 sensitive 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 ongoing comprehensive training to registered representatives, other firm personnel, third-party providers and consultants on cybersecurity risks relevant to individuals' roles and responsibilities (*e.g.,* 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).

Emerging Vendor Risk

Due to the recent increase in the number and sophistication of cyberattacks during the COVID-19 pandemic, FINRA reminds firms of their obligations to oversee, monitor and supervise cybersecurity programs and controls provided by third-party vendors.

Firms can find guidance in this area in *Regulatory Notice* 21-29 (FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors) and the Cybersecurity and Infrastructure Security Agency's (CISA) Risk Considerations for Managed Service Provider Customers.

- **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 multi-factor authentication (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, online account access and trading algorithm malfunctions due to a lack of testing for changes or system capacity issues.

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 regarding data access or data accumulation.
- **Incident Response Planning** – Establishing and regularly testing (often using tabletop exercises) a written formal incident response plan that outlines 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, mobile phones, 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 internal and third-party hardware and software changes, as well as system capacity, in order to protect non-public information and firm services.
- **Online System Capacity – Continuously monitor and test the capacity of current systems, and track average and peak utilization, to anticipate the need for additional resources based on increases in accounts or trading volumes, as well as changes in systems.**
- **Customer Account Access – Requiring customers to use MFA to access their online accounts.**

Additional Resources

FINRA's Cybersecurity Topic Page, including:

- ***Regulatory Notice 21-29* (FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors)**
- ***Regulatory Notice 21-18* (FINRA Shares Practices Firms Use to Protect Customers From Online Account Takeover Attempts)**
- *Regulatory Notice 20-32* (FINRA Reminds Firms to Be Aware of Fraudulent Options Trading in Connection With Potential Account Takeovers and New Account Fraud)
- ***Regulatory Notice 20-30* (Fraudsters Using Registered Representatives Names to Establish Imposter Websites)**
- *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
- Firm Checklist for Compromised Accounts
- Customer Information Protection Topic Page
- Cross-Market Options Supervision: Potential Intrusions Report Card
- 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:

- What methods does your firm use to identify individuals involved in undisclosed OBAs and PSTs?
- Do your firm's WSPs explicitly state when 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?

- **Upon receipt of a written notice of proposed OBAs, does your firm consider whether they will interfere with or otherwise compromise the registered person's responsibilities to the firm and the firm's customers, be viewed by customers or the public as part of the member's business or both? Does your firm also determine whether such activities should be treated as a PST (subject to the requirements of FINRA Rule 3280)?**
- Does your firm have a process in place to update a registered representative's Form U4 with activities that meet the disclosure requirements of that form?
- Does your firm take into account the unique regulatory considerations and characteristics of digital assets when reviewing digital asset OBAs and PSTs?
- Does your firm record PSTs for compensation on its books and records, including PSTs involving new or unique products and services?
- How does your firm supervise activities that are PSTs, including digital asset PSTs, and document its compliance with the supervisory obligations?

Exam Findings and Effective Practices

Exam Findings:

- **Incorrect Interpretation of Compensation** – 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 securities and tax benefits); and as a result, erroneously determining that certain activities were not PSTs.
- **Inadequate Consideration of Need to Supervise** – 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 the firm's 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 the firm's 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.
- **Inadequate Controls** – Inadequate controls to confirm adherence to limitations placed on OBAs or PSTs, such as prohibiting registered representatives from soliciting firm clients to participate in an OBA or PST.
- **No Review and Recordkeeping of Digital Asset Activities** – Failing to conduct the required assessment of OBAs that involve digital assets or incorrectly assuming all digital assets are not securities and therefore, not evaluating digital asset activities, including activities performed through affiliates, to determine whether they are more appropriately treated as PSTs; and for certain digital asset or other activities that were deemed to be PSTs for compensation, not supervising such activities or recording such transactions on the firm's books and records.

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" for issuers seeking new investors; and any expected revenues or other payments they receive from any entities other than the member firm, including affiliates).

- **Due Diligence** – Conducting due diligence to learn about all OBAs and PSTs at the time of a registered representative's initial disclosure to the firm and periodically thereafter, including interviewing the registered representative and thoroughly reviewing:
  - social media, professional networking and other publicly available websites, and other sources (such as legal research databases and court records);
  - email and other communications;
  - documentation supporting the activity (such as organizational documents); and
  - **OBAs that involve raising capital or directing securities transactions with investment advisers or fund companies in order to identify potential PSTs.** ★
- **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 selling compensation and in some cases providing FAQs to remind employees of scenarios that they might not otherwise consider to implicate these rules.
- **Training** – Conducting training on OBAs and PSTs during registered person and associated person onboarding and periodically thereafter, including regular reminders of written notice requirements and for registered persons to update their disclosures.
- **Disciplinary Action** – Imposing significant consequences—including heightened supervision, fines or termination—for persons who fail to notify firms in writing of their OBAs and PSTs, or fail to receive approval of their PSTs for compensation.
- **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* 21-25 (FINRA Continues to Encourage 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 the FINRA 4510 Rule Series (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."[6]

Additionally, firms must file a Financial Notification when selecting or changing an archival service provider, and are reminded to document the review of correspondence and confirm that individuals are not conducting supervisory reviews of their own correspondence. ★

Related Considerations:

- What kind of vendors, such as cloud service providers (Cloud Vendors), does your firm use to comply with Books and Records Rules requirements, including storing required records on electronic storage media (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 Rules policies and procedures to confirm they address all vendors, including Cloud Vendors?
- **If your firm emails its clients and customers links to Virtual Data Rooms (VDRs)—online data repositories that secure and distribute confidential information—does the firm retain and store documents embedded in those links once the VDRs are closed?**

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 firms 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 Rules, 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 vendors will provide the third-party attestation.

Additional Resources

- Frequently Asked Questions about the 2001 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

Direct Mutual Fund Business Risk

FINRA observed that some firms did not adequately supervise their direct mutual fund business (*i.e.,* selling mutual fund shares via "check and app" that are held directly by the mutual fund companies) because, for example, they were:

- maintaining blotters that did not include sufficient information to adequately supervise direct mutual fund transactions (*e.g.,* not all transactions are captured or key information is missing, such as customer name, fund symbol and share class);
- miscoding new mutual fund transactions as reinvestments or recurring contributions, which prevented them from going through firms' surveillance and supervision systems; and
- relying on *ad hoc* supervisory reviews by an insufficient number of designated principals.

As a result of these arrangements, many firms were unaware of, or had inadequate information about, direct mutual fund transactions that their registered representatives recommended or processed, and were not able to supervise them adequately. In some cases, this inability to supervise direct mutual fund business effectively resulted in firms not being able to identify inappropriate sales charge discounts, unsuitable share class recommendations and short-term mutual fund switching.

As part of their obligations under FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2110 (Recommendations), 3110 (Supervision) and Reg BI, firms must supervise all activity of their registered representatives related to direct mutual fund transactions. Additionally, Exchange Act Rules 17a-3 and 17a-4 require firms to maintain and keep current purchase and sale blotters that contain relevant information for all direct mutual fund transactions, including redemptions. When evaluating your firm's supervision of its direct mutual fund business, consider these questions:

- What portion of your firm's mutual fund business is application-based directly with mutual fund companies (in terms of dollar volume and number of accounts)?
- How do your firm's policies and procedures address supervision of your firm's direct mutual fund business? What processes (*e.g.,* regularly reviewing exception reports) does your firm use to review direct mutual fund transactions for compliance with applicable FINRA rules and securities regulations? Are such policies and procedures reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules?
- What information does your firm gather from mutual fund companies or clearing entities (*e.g.,* National Securities Clearing Corporation, Depository Trust and Clearing Corporation) to support its ability to adequately supervise its direct mutual fund business?

For additional guidance, please refer to *Regulatory Notice 21-07* (FINRA Provides Guidance on Common Sales Charge Discounts and Waivers for Investment Company Products).

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:

- Does your firm provide periodic reminders or training on such requirements, and what consequences does your firm impose on those persons who do not comply?
- How does your firm monitor for red flags of unreported written customer complaints and other reportable events?
- How does your firm confirm 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 written customer complaints, judgments concerning securities, commodities- or financial-related civil litigation 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 are the subject of any pending lawsuits or have received any written customer complaints).
- **Email Surveillance** – Conducting email surveillance targeted to identify unreported written customer 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 concerning securities, commodities- or financial-related civil litigation 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* 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

Firm Short Positions and Fails-to-Receive in Municipal Securities NEW FOR 2022

Regulatory Obligations and Related Considerations

Regulatory Obligations:

As detailed in *Regulatory Notice* 15-27, customers may receive taxable, substitute interest instead of the tax-exempt interest they were expecting when a firm effects sales to customers of municipal securities that are not under the firm's possession or control.[7] This can occur when firm trading activity inadvertently results in a short position or a firm fails to receive municipal securities it purchases to fulfill a customer's order.

Firms must develop and implement adequate controls and procedures for detecting, resolving and preventing these adverse tax consequences to customers. Such procedures must include closing out fails-to-receive within the time frame prescribed within Municipal Securities Rulemaking Board (MSRB) Rule G-12(h) and confirming that their communications with customers regarding the tax status of paid or accrued interest for municipal securities are neither false nor misleading, in accordance with MSRB Rule G-17.

Related Considerations:

- Does your firm use exception reports to manage its municipal securities' short positions or fails-to-receive? If so, how does your firm use such reports, and which departments are responsible for managing them?
- When municipal securities short positions are identified, does your firm begin to cover the shorts, or do they wait until the trades have settled?
- What is your firm's process to close out fails-to-receive in accordance with the methods and time frame prescribed under MSRB G-12(h)?
- How does your firm detect instances that would require them to pay customers substitute interest? In those circumstances, what is the firm's process for notifying impacted customers and paying them substitute interest in a timely manner? If a customer does not want to receive substitute interest, what alternatives does the firm offer (*e.g.,* offering to cancel the transaction and purchasing a comparable security that would provide tax-exempt interest)?
- How does your firm handle inbound or outbound account transfers sent through the Automated Customer Account Transfer Service (ACAT) that are delivered with no corresponding municipal bonds in possession or control?

Exam Findings and Effective Practices

Exam Findings:

- **Inadequate Controls and Procedures** – Not maintaining adequate procedures and controls for preventing, identifying and resolving adverse consequences to customers when a firm does not maintain possession or control of municipal securities that a customer owns.
- **Inadequate Lottery Systems** – Opting to use a random lottery system to allocate municipal short positions to certain customer accounts, but the system did not fairly or adequately account for or allocate substitute accrued interest payments.

Effective Practices:

- **Preventative Controls** – Maintaining processes to prevent or timely remediate municipal positions from settling short (*e.g.,* covering these positions, finding a suitable alternative, cancelling the customer's purchase).
- **Operational and Supervisory Reports** – Developing operational and supervisory reports to identify customer long positions for which the firm has not taken possession and control of the security.
- **Review of Fail Reports** – Municipal securities principals performing regular, periodic reviews of Fail Reports to comply with the close-out requirements of MSRB Rule G12-(h).

Additional Resource

- *Regulatory Notice* 15-27 (Guidance Relating to Firm Short Positions and Fails-to-Receive in Municipal Securities)

Trusted Contact Persons NEW FOR 2022

Regulatory Obligations and Related Considerations

Regulatory Obligations:

FINRA Rule 4512(a)(1)(F) (Customer Account Information) requires firms, for each of their non-institutional customer accounts, to make a reasonable effort to obtain the name and contact information for a trusted contact person (TCP) age 18 or older. FINRA Rule 4512 also describes the circumstances in which firms and their associated persons are authorized to contact the TCP and disclose information about the customer account.

Related Considerations:

- Has your firm established an adequate supervisory system, including WSPs, related to seeking to obtain and using the names and contact information for TCPs?
- Does your firm educate registered representatives about the importance of collecting and using trusted contact information, where possible?

Exam Findings and Effective Practices

Exam Findings:

- **No Reasonable Attempt to Obtain TCP Information** – Not making a reasonable attempt to obtain the name and contact information of a TCP for all non-institutional customers (*e.g.,* seeking to obtain this information only from senior non-institutional customers, not requesting this information within firm's regularly scheduled 36-month customer account records update letter).

- **No Written Disclosures** – Not providing a written disclosure explaining the circumstances under which the firm may contact a TCP when seeking to obtain TCP information (*e.g.,* when a new non-institutional account is opened or when the firm updates an existing account's information (in accordance with FINRA Rule 4512(b))).

Effective Practices:

- **Training** – Conducting training, for both front office and back office staff, on the warning signs of potential: (1) customer exploitation; (2) diminished capacity; and (3) fraud perpetrated on the customer.
- **Emphasizing the Importance of TCP and Promoting Effective Practices** –
  - Emphasizing at the senior-management level on down the importance of collecting TCP information.
  - Using innovative practices, such as creating target goals for collecting TCP and internally publicizing results among branch offices or regions.
  - Promoting effective ways of asking for TCP information and seeking feedback from registered representatives and supervisors on techniques that they have successfully used that have not already been publicized across the organization.
  - Establishing a system that notifies registered representatives when accessing non-institutional customer accounts that do not have a TCP listed and reminds them to request that information from customers.
- **Senior Investor Specialists** – Establishing specialized groups or appointing individuals to handle situations involving elder abuse or diminished capacity; contact customers' TCPs—as well as Adult Protective Services, regulators and law enforcement, when necessary—and guiding the development of products and practices focused on senior customers.
- **Firm Outreach** – Hosting conferences or joining industry groups focused on protecting senior customers.

Additional Resources

- SEC's, NAASA's and FINRA's Investor Resources for Establishing a Trusted Contact
- FINRA's Frequently Asked Questions Regarding FINRA Rules Relating to Financial Exploitation of Senior Investors
- *Regulatory Notice* 20-34 (Proposed Amendments to FINRA Rule 2165 and Retrospective Rule Review Report)

Emerging Customer Account Information Risks

Effective February 15, 2021, FINRA Rule 3241 (Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer) requires a registered person to decline being named a beneficiary of a customer's estate, executor or trustee, or to have a power of attorney for a customer unless certain conditions are met, including providing written notice to the firm and receiving approval. The rule requires the firm with which the registered person is associated, upon receiving required written notice from the registered person, to review and approve or disapprove the registered person assuming such status or acting in such capacity.

Registered persons face potential conflicts of interest when they are named a customer's beneficiary, executor or trustee, or hold a power of attorney for their customer. These conflicts of interest can take many forms and can include a registered person benefiting from the use of undue and inappropriate influence over important financial decisions to the detriment of a customer.

When assessing your firm's compliance with Rule 3241, consider these questions:

- Do your firm's policies and procedures establish criteria for determining whether to approve a registered person assuming either status or acting in either capacity?
- Does your firm perform a reasonable assessment of the risks created by a registered person being named a customer's beneficiary or holding a position of trust for a customer?
- If your member firm imposes conditions or limitations on its approval, does it reasonably supervise the registered person's compliance with the corresponding conditions or limitations?
- Does your firm have WSPs, and deliver training, reasonably designed to make registered persons aware of the obligations under the rule and the firm's related procedures?

Funding Portals and Crowdfunding Offerings NEW FOR 2022

Regulatory Obligations and Related Considerations

Regulatory Obligations:

Title III of the Jumpstart Our Business Startups (JOBS) Act enacted in 2012 contains provisions relating to securities offered or sold through crowdfunding. The SEC's Regulation Crowdfunding and FINRA's corresponding set of Funding Portal Rules set forth the principal requirements that apply to funding portal members.

Funding portals must register with the SEC and become a member of FINRA. Broker-dealers contemplating engaging in the sale of securities in reliance on the crowdfunding exemptions must notify FINRA in accordance with FINRA Rule 4518 (Notification to FINRA in Connection with the JOBS Act).

Related Considerations:

- What steps is your firm taking to confirm all required issuer information, pursuant to Regulation Crowdfunding Rules 201 and 203(a), is publicly available on your firm's platform?
- Does your firm plan to undergo or has it already undergone an operational or structural change that impacts the capitalization of the firm, pursuant to Funding Portal Rule 110(a)(4)? Has your firm reviewed the membership rules to confirm a Continuing Membership Application (CMA) is not required?

Exam Findings and Effective Practices

Exam Findings:

- **Failure to Obtain Attestation** – Not obtaining the attestation required by Regulation Crowdfunding Rule 404 when using a third-party vendor to store the required records.
- **Missing Disclosures** – Offerings on the platform do not contain all required disclosures as codified in Regulation Crowdfunding, in particular:
  - names of officers and directors of the issuer, and the positions held by these individuals for the past three years;
  - descriptions of the purpose and intended use of proceeds, the process to complete the offering transaction or cancel an investment commitment, the ownership and capital structure, the material terms of any indebtedness of the issuer; and
  - financial statements, as required by Regulation Crowdfunding Rule 201(t).
- **Failure to Report Customer Complaints** – Not reporting written customer complaints, as required by FINRA Funding Portal Rule 300(c).
- **Untimely Required Filings** – Not making required filings in a timely manner—such as filing the funding portal's Statement of Gross Revenue by the deadline of March 1—and not filing updates or changes to contact information within 30 days of the change.
- **Not Filing CMAs** – Funding portals effecting changes in ownership without obtaining prior approval from FINRA, as required by Funding Portal Rule 110(a)(4).

Effective Practices:

- **Compliance Resources** – Developing 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), as well as compliance checklists and schedules to confirm that required obligations are being met in a timely manner, such as providing all issuer disclosure requirements of Regulation Crowdfunding Rule 201.
- **Supervision** – Implementing supervisory review procedures tailored to funding portal communications requirements that, for example, clearly define permissible and prohibited communications and identify whether any contemplated structural or organizational changes necessitate the filing of a CMA.

Additional Resource

- FINRA's Funding Portals Topic Page

Communications and Sales

Reg BI and Form CRS

Regulatory Obligations and Related Considerations

Regulatory Obligations:

The SEC's Regulation Best Interest (Reg BI) establishes a "best interest" standard of conduct for broker-dealers and associated persons when they make recommendations to retail customers of any securities transaction or investment strategy involving securities, including account recommendations. **Pursuant to this standard, a broker-dealer and its associated persons must not put their financial or other interests ahead of the interests of a retail customer.**

In addition, whether or not they make recommendations, firms that offer services to retail investors must provide them with a Form CRS, a brief relationship summary that discloses material information in plain language (*e.g.,* investment services provided, fees, conflicts of interest, legal and disciplinary history of the firms and financial professionals).

Reg BI and Form CRS became effective on June 30, 2020, and 2021 marked the first full calendar year during which FINRA examined firms' implementation of related obligations. The findings presented here are thus an initial look at firms' practices. FINRA will share further findings as we continue to conduct exams and gather additional information on firms' practices.

Related Considerations:

- **When your firm determines whether it is obligated to comply with Reg BI, does your firm consider the following key definitions in the context of the rule?**
  - **"Retail customer" is defined as "a natural person, or the legal representative of such natural person, who:**
    - **receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer; and**
    - **uses the recommendation primarily for personal, family, or household purposes."**
  - **A retail customer "uses" a recommendation of a securities transaction or investment strategy involving securities when, as a result of the recommendation[8]:**
    - **the retail customer opens a brokerage account with the broker-dealer, regardless of whether the broker-dealer receives compensation;**
    - **the retail customer has an existing account with the broker-dealer and receives a recommendation from the broker-dealer, regardless of whether the broker-dealer receives or will receive compensation, directly or indirectly, as a result of that recommendation[9]; or**
    - **the broker-dealer receives or will receive compensation, directly or indirectly as a result of that recommendation, even if that retail customer does not have an account at the firm.**
- **Do your firm and your associated persons adhere to the Care Obligation of Reg BI when making recommendations by:**
  - **exercising reasonable diligence, care and skill to understand the potential risks, rewards and costs associated with a recommendation and having a reasonable basis to believe, based on that understanding, that the recommendation is in the best interest of at least some retail investors;**

  - **considering those risks, rewards and costs in light of the retail customer's investment profile and having a reasonable basis to believe that a recommendation is in that particular customer's best interest and does not place the broker-dealer's interest ahead of the customer's interest; and**
  - **having a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile?**
- **Do your firm and your associated persons consider costs and reasonably available alternatives when making recommendations to retail customers?**
- **Are your firm's policies and procedures reasonably designed to identify and disclose or eliminate conflicts, as well as to mitigate conflicts that create an incentive for an associated person of the firm to place his or her interests or the interest of the firm ahead of the retail customer's interest?**
- **How does your firm test its policies and procedures to determine if they are adequate and performing as expected?**
- Does your firm place any material limitations on the securities or investment strategies involving securities that may be recommended to a retail customer? If so, does your firm identify and disclose such limitations and prevent those limitations from causing the firm or its associated persons to make recommendations that place the firm's or associated person's interests ahead of the retail customer's interest?
- **Are your firm's policies and procedures reasonably designed to identify and eliminate sales contests, sales quotas, bonuses and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time, or mitigate conflicts for those not required to be eliminated?**
- **Do your firm's disclosures include a full and fair disclosure of all material facts relating to the scope and terms of the firm's relationship with retail customers (*e.g.,* material fees and costs associated with transactions or accounts, material limitations involving securities recommendations) and all material facts relating to conflicts of interest that are associated with the recommendation?**
- **What controls does your firm have to assess whether disclosures are provided timely, and if provided electronically, in compliance with the SEC's electronic delivery guidance?**
- **Do your firm's policies and procedures address Reg BI, including new obligations that did not exist prior to Reg BI?**
- **Do your firm's policies and procedures: (1) identify specific individual(s) who are responsible for supervising compliance with Reg BI; (2) specify the supervisory steps and reviews appropriate supervisor(s) should take and their frequency; and (3) note how supervisory reviews should be documented?**
- If your firm is not dually registered as an investment adviser, commodity trading advisor, municipal advisor or advisor to a special entity, do the firm or any of its associated persons who are not dually registered use "adviser" or "advisor" in their name or title?
- **Does the firm provide dually-registered associated persons with adequate guidance on how to determine and disclose the capacity in which they are acting?**
- Has your firm provided adequate Reg BI training to its associated persons, including supervisory staff?
- **If your firm offers services to retail investors:**
  - **does it deliver Form CRS to each new or prospective customer who is a retail investor before the earliest of: (i) a recommendation of an account type, securities transaction or investment strategy involving securities; (ii) placing an order for the retail investor; or (iii) opening a brokerage account for the investor?**

- **for existing retail investor customers, does the firm deliver Form CRS before or at the time the firm: (i) opens a new account that is different from the retail customer's existing account; (ii) recommends that the retail customer roll over assets from a retirement account; or (iii) recommends or provides a new service or investment outside of a formal account (*e.g.,* variable annuities or a first-time purchase of a direct-sold mutual fund through a "check and application" process)?**
- **does it file a relationship summary with the SEC through the Central Registration Depository (CRD), if the firm is registered as a broker-dealer; through the Investment Adviser Registration Depository (IARD), if the firm is registered as an investment adviser; or both CRD and IARD, if the firm is a dual-registrant?**
- **does your firm have processes in place to update and file the amended Form CRS within 30 days whenever any information becomes materially inaccurate and to communicate, without charge, any changes in the updated relationship summary to retail investors who are existing customers within 60 days after the updates are required to be made (a total of 90 days to communicate the changes to customers after the information becomes materially inaccurate)?**

Exam Findings and Effective Practices

Exam Findings:

Reg BI and Form CRS

- **WSPs That Are Not Reasonably Designed To Achieve Compliance with Reg BI and Form CRS –**
  - **Providing insufficiently precise guidance by:**
    - **not identifying the specific individuals responsible for supervising compliance with Reg BI; and**
    - **stating the rule requirements, but failing to detail how the firm will comply with those requirements (*i.e.,* stating "what" but failing to address "how").**
  - **Failing to modify existing policies and procedures to reflect Reg BI's requirements by:**
    - **not addressing how costs and reasonably available alternatives should be considered when making recommendations;**
    - **not addressing recommendations of account types;**
    - **not addressing conflicts that create an incentive for associated persons to place their interest ahead of those of their customers; and**
    - **not including provisions to address Reg BI-related recordkeeping obligations and the testing of the firms' Reg BI and Form CRS policies, procedures and controls.**
  - **Failing to develop adequate controls or developing adequate controls but not memorializing these processes in their WSPs.**
- **Inadequate Staff Training – Failing to adequately prepare associated persons to comply with the requirements of Reg BI beyond previous suitability obligations or Form CRS by:**
  - **failing to deliver initial training before the June 30, 2020, compliance date;**
  - **delivering training without making clear Reg BI's new obligations; or**
  - **delivering training that focused on Reg BI and Form CRS requirements in general, without addressing the specific steps associated persons should take to comply with these requirements.**

- **Failure to Comply With Care Obligation –**
  - **Making recommendations that were not in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards and costs associated with the recommendation.**
  - **Recommending a series of transactions that were excessive in light of a retail customer's investment profile and placing the broker-dealer's or associated person's interest ahead of those of retail customers.**
- **Failure to Comply with Conflict of Interest Obligation – Not identifying conflicts or, if identified, not adequately addressing those conflicts.**
- **Improper Use of the Terms "Advisor" or "Adviser" – Associated persons, firms or both, using the terms "advisor" or "adviser" in their titles or firm names, even though they lack the appropriate registration.[10]**
- **Insufficient Reg BI Disclosures – Not providing retail customers with "full and fair" disclosures of all material facts related to the scope and terms of their relationship with these customers or related to conflicts of interest that are associated with the recommendation, including:**
  - **material fees received as a result of recommendations made (*e.g.,* revenue sharing or other payments received from product providers or issuers, as well as other fees tied to recommendations to rollover qualified accounts);**
  - **potential conflicts of interest (*e.g.,* associated persons trading in the same securities in their personal account(s) or outside employment); and**
  - **material limitations in securities offerings.**

Form CRS

- **Deficient Form CRS Filings – Firms' Form CRS filings significantly departing from the Form CRS instructions or guidance from the SEC's FAQ on Form CRS by:**
  - **exceeding prescribed page lengths;**
  - **omitting material facts (*e.g.,* description of services offered; limitations of the firm's investment services);**
  - **inaccurately representing their financial professionals' disciplinary histories;**
  - **failing to describe types of compensation and compensation-related conflicts;**
  - **incorrectly stating that the firm does not provide recommendations;**
  - **changing or excluding language required by Form CRS; and**
  - **not resembling a relationship summary, as required by Form CRS.[11]**
- **Form CRS Not Posted Properly on Website – For firms that have a public website, failing to post or failing to post prominently, in a location and format that is easily accessible to retail investors, the current Form CRS (*e.g.,* requiring multiple click-throughs or using confusing descriptions to navigate to the Form CRS).**
- **Inadequate Form CRS Amendments – Firms not in compliance with Form CRS in relation to material changes because they:**
  - **failed to re-file in CRD in a timely manner (*i.e.,* within 30 days of the date when Form CRS became materially inaccurate); or**

- **failed to communicate or timely communicate changes to existing retail investor customers (*e.g.,* delivering amended summary, with required exhibits, showing revised text or summarizing material changes or communicating the information through another disclosure within 60 days after the updates are required to be made—90 days total from the date when Form CRS became materially inaccurate).**

- **Misconstruing Obligation to File Form CRS –**
  - **Incorrectly determining that filing Form CRS hinges solely on making recommendations, rather than offering services to a retail investor.**
  - **Incorrectly claiming a firm is not subject to the Form CRS delivery obligation because of, among other things, their customer base (*e.g.,* retail investors who are high-net-worth individuals) or the services they offer (*e.g.,* investment company products held directly by an issuer, self-directed accounts)**

Effective Practices:

- **Identifying and Mitigating Conflicts of Interest – Identifying, disclosing, and eliminating or mitigating conflicts of interest across business lines, compensation arrangements, relationships or agreements with affiliates, and activities of their associated persons by:**
  - **establishing and implementing policies and procedures to identify and address conflicts of interest, such as through the use of conflicts committees or other mechanisms or creating conflicts matrices tailored to the specifics of the firm's business that address, for example, conflicts across business lines and how to eliminate, mitigate or disclose those conflicts;**
  - **sampling recommended transactions to evaluate how costs and reasonably available alternatives were considered;**
  - **providing resources to associated persons making recommendations that account for reasonably available alternatives with comparable performance, risk and return that may be available at a lower cost, such as:**
    - **worksheets, in paper or electronic form, to compare costs and reasonably available alternatives; or**
    - **guidance on relevant factors to consider when evaluating reasonably available alternatives to a recommended product (*e.g.,* similar investment types from the issuer; less complex or risky products available at the firm);**
  - **updating client relationship management (CRM) tools that automatically compare recommended products to reasonably available alternatives;**
  - **revising commission schedules within product types to flatten the percentage rate; and**
  - **broadly prohibiting all sales contests.**

- **Limiting High-Risk or Complex Investments for Retail Customers – Mitigating the risk of making recommendations that might not be in a retail customer's best interest by:**
  - **establishing product review processes to identify and categorize risk and complexity levels for existing and new products;**
  - **limiting high-risk or complex product, transaction or strategy recommendations to specific customer types; and**
  - **applying heightened supervision to recommendations of high-risk or complex products.**

- **Implementing Systems Enhancements for Tracking Delivery of Required Customer Documents – Tracking and delivering Form CRS and Reg BI-related documents to retail investors and retail customers in a timely manner by:**
  - **automating tracking mechanisms to determine who received Form CRS and other relevant disclosures; and**
  - **memorializing delivery of required disclosures at the earliest triggering event.**
- **Implementing New Surveillance Processes – Monitoring associated persons' compliance with Reg BI by:**
  - **conducting monthly reviews to confirm that their recommendations meet Care Obligation requirements, including system-driven alerts or trend criteria to identify:**
    - **account type or rollover recommendations that may be inconsistent with a customer's best interest;**
    - **excessive trading; and**
    - **sale of same product(s) to a high number of retail customers;**
  - **monitoring communication channels (*e.g.*, email, social media) to confirm that associated persons who were not investment adviser representatives (IARs) were not using the word "adviser" or "advisor" in their titles; and**
  - **incorporating Reg BI-specific reviews into the branch exam program as part of overall Reg BI compliance efforts, focusing on areas such as documenting Reg BI compliance and following the firms' Reg BI protocols.**

Additional Resources

- FINRA's SEC Regulation Best Interest Key Topics Page
- SEC's Regulation Best Interest Guidance Page
- SEC's Staff Statement Regarding Form CRS Disclosure
- 2021 FINRA Annual Conference: Regulation Best Interest and Form CRS: Recent Observations and What to Expect Panel
- 2021 Small Firm Virtual Conference: Regulation Best Interest and Form CRS Panel
- You may submit a question by email to IABDQuestions@sec.gov. Additionally, you may contact the SEC's Division of Trading and Markets' Office of Chief Counsel at (202) 551-5777.

Areas of Concern Regarding SPACs

Over the past year, FINRA's review of firms participating in SPAC offerings has focused on the following.

Due Diligence – When firms and associated persons act as underwriter, qualified independent underwriter or syndicate member for a SPAC offering, the due diligence conducted at the IPO and merger stages, including as to the relevant officers, directors and control persons of the SPAC and SPAC-sponsor(s) and pre-identified acquisition targets.

Reg BI – Written policies and procedures or guidance on recommendations to retail customers, and supervisory systems designed to identify and address conflicts of interest presented by the involvement of the firm, their associated persons or both.

Disclosure – Firms' supervision of associated persons who hold positions with, advise or personally invest in SPACs or SPAC sponsors, and whether the associated persons are disclosing their involvement if required by FINRA rules governing OBAs, PSTs and Form U4 amendments.

Net Capital – In firm-commitment underwritings, whether firms are correctly taking net capital charges relative to the size of their commitment or using a written agreement with another syndicate member (*i.e.,* "backstop provider").

WSPs and Supervisory Controls – whether firms are maintaining and regularly updating their WSPs and supervisory controls to address risks related to SPACs (*e.g.,* Reg BI, due diligence, information barrier policies, conflicts of interest).

In October 2021, FINRA initiated a targeted review to explore the above areas and other issues relating to SPACs. Additional review areas include training; the use of qualified independent underwriters; underwriting compensation; services provided to SPACs, their sponsors or affiliated entities; and potential merger targets. It is anticipated that, at a future date, FINRA will share with member firms its findings from this review.

Communications with the Public

Regulatory Obligations and Related Considerations

Regulatory Obligations:

FINRA Rule 2210 (Communications with the Public) defines 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. **New member firms are required to file retail communications with FINRA's Advertising Regulation Department during their first year of membership.** ★

FINRA Rule 2220 (Options Communications) governs members' communications with the public concerning options. Additionally, MSRB Rule G-21 (Advertising by Brokers, Dealers or Municipal Securities Dealers) contains similar content standards relating to municipal securities or concerning the facilities, services or skills of any municipal dealer.

Related Considerations:

- **General Standards –**
  - Do your firm's communications contain false, misleading or promissory statements or claims?
  - 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 predictions or projections of investment performance to investors that are generally prohibited by FINRA Rule 2210(d)(1)(F)?
- **Mobile Apps –**
  - **Has your firm established and implemented a comprehensive supervisory system for communications through mobile apps?**
  - **Have you tested the accuracy of account information, including labels and data, displayed in your mobile apps?**
  - **Do your mobile apps accurately describe how their features work?**
  - **Do your mobile apps identify information in ways that are readily understandable, based on the experience level of your customers?**
  - **Do your mobile apps provide investors with readily available information to explain complex strategies and investments and associated risks?**
  - **If your firm offers an app to retail customers, does the information provided to customers constitute a "recommendation" that would be covered by Reg BI, and in the case of recommendations of options or variable annuities, FINRA Rules 2360 (Options) or 2330 (Members' Responsibilities Regarding Deferred Variable Annuities)? If so, how does your firm comply with these obligations?**
- **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 Books and Records Rules for all approved digital communications?
  - Does your firm have a process to confirm that all business-related communications 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?
  - assure 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 accounts insured by the Federal Deposit Insurance Corporation (FDIC); and
    - FDIC insurance coverage applies to funds when held at 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
    - benefits and risks of participating in such programs?
- **Municipal Securities Communications – If your firm offers municipal securities, does it confirm that advertisements for such securities include the necessary information to be fair, balanced and not misleading, and do not include:**
  - **exaggerated claims about safety or misleading comparisons to US Treasury Securities;**
  - **statements claiming "direct access" to bonds in the primary market if the firm is not an underwriter; and**
  - **unwarranted claims about the predictability or consistency of growth or payments?**
- **If an advertisement includes claims of municipal securities being "tax free," does it also explain any applicable state, local, alternative minimum tax, capital gains or other tax consequences?**
- **If an advertisement advertises a "taxable equivalent" yield on a municipal security offering, does it provide sufficient information regarding the tax bracket used to make the calculation?**

Exam Findings and Effective Practices

Exam Findings:

- **False, Misleading and Inaccurate Information in Mobile Apps –**
  - **Incorrect or misleading account balances or inaccurate information regarding accounts' historical performance.**
  - **Sending margin call warnings to customers whose account balances were not approaching, or were below, minimum maintenance requirements.**
  - **Falsely informing customers that their accounts were not enabled to trade on margin, when the accounts were, in fact, margin enabled.**
  - **Misstating the risk of loss associated with certain options transactions.**
  - **Distributing false and misleading promotions through social media and "push" notifications on mobile apps that made promissory claims or omitted material information.**

- **Deficient Communications Promoting Digital Assets –**
  - **Falsely identifying the broker-dealer as the entity from whom digital assets may be purchased or creating confusion about which entity is offering digital assets by using identical or substantially similar names to the broker dealer's name.**
- **Misrepresentations in Cash Management Account Communications –**
  - **Misleading statements or claims that either state or imply the broker-dealer is a bank.**
  - Misleading or false claims that state or imply the Cash Management Accounts are "checking and savings accounts."
  - Inaccurate or misleading statements concerning the amount of FDIC insurance coverage provided to investor funds when they are held at a partner bank.
  - Incomplete or inaccurate claims concerning the amount of time it may take for customer funds to reach the bank accounts or be available to investors once deposited at a partner bank.
  - Inaccurate or misleading claims about the actual terms of the Cash Management Accounts.
  - **Failure to balance promotional claims with the risks of participating in such programs.**
- **Insufficient Supervision and Recordkeeping for Digital Communications** – 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 business-related digital communications methods not controlled by the firm, 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.
  - Not including a "readily apparent reference" and hyperlink to FINRA's BrokerCheck in such communications.
- **Municipal Securities Advertisements – Using false and misleading statements or claims about safety, unqualified or unwarranted claims regarding the expertise of the firm, and promissory statements and claims regarding portfolio growth.**

Effective Practices:

- **Comprehensive Procedures for Mobile Apps – Maintaining and implementing comprehensive procedures for the supervision of mobile apps, for example, that confirm:**
  - **data displayed to customers is accurate; and**
  - **information about mobile apps' tools and features complies with FINRA's communications and other relevant rules before it is posted to investors.**
- **Comprehensive Procedures for Digital Communications** – Maintaining and implementing procedures for supervision of digital communication channels, including:
  - **Monitoring of New Tools and Features** – Monitoring 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 them to take 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 that are needed to balance any statements or claims contained in a digital asset communication, 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:
  - **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.
  - **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.
  - **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.

- **Municipal Securities Advertisements – Maintaining and implementing procedures for firm municipal securities communications, including:**
  - **Prior Approval – Requiring prior approval of all advertisements concerning municipal securities by an appropriately qualified principal to confirm the content complies with applicable content standards.**
  - **Training – Providing education and training for firm personnel on applicable FINRA and MSRB rules and firm policies.**
  - **Risk Disclosure – Balancing statements concerning the benefits of municipal securities by prominently describing the risks associated with municipal securities, including credit risk, market risk and interest rate risk.**
  - **Review – Reviewing firms' communications to confirm that the potential benefits of tax features are accurate and not exaggerated.**

Additional Resources

- *Regulatory Notice* 21-25 (FINRA Continues to Encourage 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
- FINRA's Social Media Topic Page
- ***MSRB Notice 2019-07***
- ***MSRB Notice 2018-18***

Private Placements

Regulatory Obligations and Related Considerations

Regulatory Obligations:

In *Regulatory Notice* 10-22 (Obligations of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings), FINRA noted that members that recommend private offerings have obligations under FINRA Rule 2111 (Suitability) and FINRA Rule 3110 (Supervision) to conduct reasonable diligence 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." **Although FINRA's Suitability Rule continues to apply to recommendations to non-retail customers, it no longer applies to recommendations to retail customers. Instead, the SEC's Reg BI applies to recommendations to retail customers of any securities transaction or investment strategy involving securities, including recommendations of private offerings.**

Additionally, 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), and should also be aware of recent amendments to these rules.[12] ★

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 confirm that associated persons conduct reasonable diligence prior to recommending private placement offerings, including conducting further inquiry into red flags?
- How does your firm address red flags regarding conflicts of interest identified during the reasonable diligence process and in third-party due diligence reports?
- How does your firm manage the transmission of funds and amended terms in contingency offerings, including ensuring compliance with Securities Exchange Act Rules 10b-9 and 15c2-4, as applicable?

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 12 months after the offering closing date).
- **No Reasonable Diligence** – Failing to perform reasonable diligence of private placement offerings prior to recommending them to retail investors, including:
  - **failing to conduct an appropriate level of research, particularly when the firm lacks experience or specialized knowledge pertaining to an issuer's underlying business or when an issuer lacks an operating history;**
  - **relying unreasonably on the firm's experience with the same issuer in previous offerings;** and
  - failing to inquire into and analyze red flags identified during the reasonable-diligence process or in third-party due diligence reports.

Effective Practices:

- **Private Placement Checklist** – Creating checklists with—or adding to existing due diligence checklists—all steps, filing dates and related documentation requirements, noting staff responsible for performing functions and tasks and evidence of supervisory principal approval for the reasonable diligence process and 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 deemed material to a potential investor (such as liquidity restrictions).
- **Independent Verification** – Verifying information that is 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), in some cases with support from law firms, experts and other third-party vendors.

- **Identifying Conflicts of Interest** – Using firms' reasonable diligence processes to identify conflicts of interest (*e.g.,* firm affiliates or issuers whose control persons were also employed by the firm) and then addressing such conflicts (such as by confirming that the issuer prominently and comprehensively discloses these conflicts in offering documents or mitigating them by removing financial incentives to recommend a private offering over other more appropriate investments).
- **Responsibility for Reasonable Diligence and Compliance** – Assigning responsibility for private placement reasonable diligence and compliance with filing requirements to specific individual(s) or team(s) and conducting targeted, in-depth training about the firms' policies, process and filing requirements.
- **Alert System** – Creating a system that alerts responsible individual(s) and supervisory principal(s) about upcoming and missed filing deadlines.
- **Post-Closing Assessment** – Conducting reviews after the offering closes to ascertain whether offering proceeds were used in a manner consistent with the offering memorandum.

Additional Resources

- ***Regulatory Notice* 21-26 (FINRA Amends Rules 5122 and 5123 Filing Requirements to Include Retail Communications That Promote or Recommend Private Placements)**
- ***Regulatory Notice* 21-10 (FINRA Updates Private Placement Filer Form Pursuant to FINRA Rules 5122 and 5123)**
- ***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

Conservation Donation Transactions Risks

FINRA is seeing continued syndications of Conservation Donation Transactions (CDTs) investment programs among broker-dealers. CDTs commonly involve private placement offerings where investor returns are based on a share of tax savings from a charitable donation. In practice, CDTs involve unrelated investors acquiring an interest in a passthrough entity (*i.e.,* a partnership or limited liability company) owning unimproved land. Before year-end, the passthrough entity either grants a conservation easement—which forever limits future development of the land—or outright donates the land to a land trust. In exchange, the passthrough entity receives charitable donation tax deductions, which serve as a return on investment to investors and often have values based solely on land appraisals that are predicated on an alternative plan to develop the land, oftentimes the equivalent of four to more than 10 times the price paid to acquire the land. (Common CDTs involve syndicated conservation easement transactions (SCETs) or substantially similar, fee simple donations of land.)

Firms that engage in CDTs should consider the following questions to determine whether they meet regulatory obligations:

- Do the CDT sponsor, appraiser or other related service providers have any prior, adverse audit history?
- Do your firm's offering disclosures present potential conflicts of interest among sponsors, consultants, land developers, prior landowners, broker-dealers, and registered persons having employment or affiliated relationships?
- In compliance with Reg BI, does your firm:
  - consider reasonably available alternatives to any recommendation of CDTs (*i.e.,* the Care Obligation);
  - have policies and procedures to identify and—at a minimum—disclose or eliminate all conflicts of interest associated with the recommendation (*i.e.,* the Conflicts of Interest Obligation); and
  - have policies and procedures to identify and mitigate any conflicts of interest associated with recommendations of CDTs that create an incentive for an associated person to place the interest of the firm or the associated person ahead of the retail customer's interest?
- In compliance with SEA Rule 15c2-4, does your firm promptly transmit funds to either an escrow agent or a separate bank account (as CDTs are typically associated with contingent offerings)?
- How does your firm establish and document reasonable diligence of CDTs, including further inquiries in the presence of red flags (*e.g.,* CDTs resulting in donation deductions that are more than two-and-one-half times an investor's investment, concerns surfaced in third-party due diligence reports, large markups associated with land acquisition, certain types of fees to related parties, marketing communications promoting CDTs solely on their tax benefits)?

For additional guidance, please refer to these resources:

- FINRA, 2018 Report on Examination Findings – Reasonable Diligence for Private Placements (Dec. 7, 2018)
- United States Senate, Report on Syndicated Conservation-Easement Transactions
- Internal Revenue Service, IRS increases enforcement action on Syndicated Conservation Easements (Nov. 12, 2019)
- Internal Revenue Service, IRS concludes "Dirty Dozen" list of tax scams for 2019: Agency encourages taxpayers to remain vigilant year-round (Mar. 20, 2019)
- Land Trust Alliance, Important Advisory: Tax Shelter Abuse of Conservation Donations (Feb. 1, 2018)
- Internal Revenue Service, Notice 2017-10, Listing Notice – Syndicated Conservation Easement Transactions

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. 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, Rule 2330 requires firms to establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the rule. Firms must implement surveillance procedures to determine if any associated person is effecting deferred variable annuity exchanges at a rate that might suggest conduct inconsistent with FINRA Rule 2330 and any other applicable FINRA rules or the federal securities laws.

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?
- How do your firm's WSPs support a determination that a variable annuity exchange has a reasonable basis? How do you obtain, evaluate and record relevant information, such as:
  - loss of existing benefits;
  - increased fees or charges;
  - surrender charges, or the establishment or creation of a new surrender period;
  - consistency of customer liquid net worth invested in the variable annuity with their liquidity needs;
  - whether a share class is in the customer's best interest, given his or her financial needs, time horizon and riders included with the contract; and
  - prior exchanges within the preceding 36 months?
- Do your firm's policies and procedures require registered representatives to inform customers of the various features of recommended variable annuities such as surrender charges, potential tax penalties, various fees and costs, and market risk?
- What is the role of your registered principals in supervising variable annuity transactions, including verifying how the customer would benefit from certain features of deferred variable annuities (*e.g.,* 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?
- **What is your firm's process to supervise registered representatives who advise their clients' decisions whether or not to accept a buyout offer?**

Exam Findings and Effective Practices

Exam Findings:

- **Exchanges** – Not reasonably supervising recommendations of exchanges for compliance with FINRA Rule 2330 and Reg BI, leading to 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.
- **Insufficient Training** – Not conducting training for registered representatives and supervisors regarding how to assess costs and fees, surrender charges and long-term income riders to determine whether exchanges were suitable for customers.
- **Poor and Insufficient Data Quality – Not collecting and retaining key information on variable annuity transactions, particularly in connection with exchange transactions; relying on processes for data collection and retention in situations where the volume of variable annuity transactions renders these processes ineffective; and failing to address inconsistencies in available data for variable annuities, as well as data formats and reporting processes.**
- **Issuer Buyouts** – Not reasonably supervising recommendations related to issuer buyout offers (*e.g.,* associated persons' recommendations that investors surrender the contract in order to generate an exchange or new purchase) for compliance with FINRA Rule 2230 and Reg BI.

Effective Practices:

- **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.
- **Automated Data Supervision – Creating automated solutions to synthesize variable annuity data (including general product information, share class, riders and exchange-based activity) in situations warranted by the volume of variable annuity transactions.**
- **Data Integrity** – Engaging with insurance carriers (affiliated and non-affiliated) and third-party data providers (*e.g.,* DTCC and consolidated account report providers) to address inconsistencies in available data, data formats and reporting processes for variable annuities.
- **Data Acquisition – Establishing a supervisory system that collects and utilizes key transaction data, including, but not limited to:**
  - **transaction date;**
  - **rep name;**
  - **customer name;**
  - **customer age;**
  - **investment amount;**
  - **whether the transaction is a new contract or an additional investment;**
  - **contract type (qualified vs. non-qualified);**

- **contract number;**
- **product issuer;**
- **product name;**
- **source of funds;**
- **exchange identifier;**
- **share class; and**
- **commissions.**

- **Data Analysis – Considering the following data points when conducting a review of an exchange transaction under FINRA Rule 2330 and Reg BI:**
  - **branch location;**
  - **customer state of residence;**
  - **policy riders;**
  - **policy fees;**
  - **issuer of exchanged policy;**
  - **exchanged policy product name;**
  - **date exchanged policy was purchased;**
  - **living benefit value, death benefit value or both, that was forfeited;**
  - **surrender charges incurred; and**
  - **any additional benefits surrendered with forfeiture.**

Additional Resources

- SEC
  - Regulation Best Interest, Form CRS and Related Interpretations
- FINRA
  - Regulation Best Interest (Reg BI) Topic Page
  - *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

Market Integrity

Consolidated Audit Trail (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; and timeliness, accuracy and completeness of data requirements. *Regulatory Notice* 20-31 (FINRA Reminds Firms of Their Supervisory Responsibilities Relating to CAT) describes 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: (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 your firm reports, or that is reported 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 your firm will self-report clock synchronization violations?
- Does your firm conduct daily reviews of the Industry Member CAT Reporter Portal (CAT Reporter Portal) to review file status to confirm the file(s) sent by the member or by their reporting agent was accepted by CAT and to identify and 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?
- **Does your firm maintain the required CAT order information as part of its books and records and in compliance with FINRA Rule 6890 (Recordkeeping)?**
- **How does your firm work with its clearing firm and third-party vendors to maintain CAT compliance?**

Exam Findings and Effective Practices

Exam Findings:

- **Inaccurate Reporting of CAT Orders – Submitting information that was incorrect, incomplete or both to the Central Repository, such as:**
  - **account holder type;**
  - **buy/sell side;**
  - **cancel quantity;**
  - **route event quantity (*e.g.,* reporting an old quantity that had been modified to a different amount);**

- **trading session code;**
- **new order code;**
- **department type code (*e.g.,* reporting "A" for agent, when the firm does not execute orders);**
- **time in force;**
- **handling instructions (*e.g.,* reporting new order events as Stop on Quote (SOQ) or Stop Limit on Quote (SLQ)); and**
- **representative indicator (*i.e.,* reporting the representative indicator to reflect a representative order when the order in a firm account was not created for the purpose of working one or more customer or client orders).**

- **Late Resolution of Repairable CAT Errors – Not resolving repairable CAT errors in a timely manner (*i.e.,* within the T+3 requirement).**
- **Inadequate Vendor Supervision – Not establishing and maintaining WSPs or supervisory controls regarding both CAT reporting and clock synchronization that are performed by third-party vendors.**

Effective Practices:

- **Supervision – Implementing a comparative review of CAT submissions versus firm order records; and utilizing CAT Report Cards and CAT FAQs to design an effective supervision process.**
- **Clock Synchronization Related to Third Parties – Obtaining adequate information from third parties to meet applicable clock synchronization requirements.[13]**

Additional Resources

- CAT NMS Plan
- FINRA
  - Consolidated Audit Trail (CAT) Topic Page
  - Equity Report Cards
  - *Regulatory Notice* 20-31 (FINRA Reminds Firms of Their Supervisory Responsibilities Relating to CAT)
  - *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)

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 firm and persons associated with a member firm 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. Where a firm may choose to not conduct an order-by-order review—to the extent consistent with Rule 5310 and associated guidance—it must have procedures in place to confirm it periodically conducts "regular and rigorous" reviews of the execution quality of its customers' orders.

Best execution obligations apply to any member firm that receives customer orders—for purposes of handling and execution—including firms that receive orders directly from customers, as well as those that receive customer orders from other firms for handling and execution, such as wholesale market makers.[14] These obligations also apply when a firm acts as agent for the account of its customer and executes transactions as principal. Any firm subject to FINRA Rule 5310 cannot transfer its duty of best execution to another person; additionally, any firm that routes all of its customer orders to another firm without conducting an independent review of execution quality would violate its duty of best execution.

Related Considerations:

- How does your firm determine whether to employ order-by-order or "regular and rigorous" reviews of execution quality?
- If applicable, how does your firm implement and conduct an adequate "regular and rigorous" review of the quality of the executions of its customers' orders and orders from a customer of another broker-dealer?
- If applicable, 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 compare the execution quality received under its existing order routing and execution arrangements (including the internalization of order flow) to the quality of the executions it could obtain from competing markets (whether or not the firm already has routing arrangements with them), including off-exchange trading venues?**
- **How does your firm address potential conflicts of interest in order routing decisions, including those involving:**
  - **affiliated entities (*e.g.,* affiliated broker-dealers, affiliated alternative trading systems (ATSs));**
  - **market centers, including off-exchange trading venues, that provide payment for order flow (PFOF) or other order-routing inducements; and**
  - **orders from customers of another broker-dealer for which your firm provides PFOF?**
- **If your firm provides PFOF to another broker-dealer, how does your firm prevent those payments from interfering with your firm's best execution obligations (including situations where you provide PFOF and execute the covered orders)?**
- If your firm engages in fixed income and options trading, has it established targeted policies and procedures to address 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?
- How does your firm meet 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 affecting pricing 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 in 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 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 orders to affiliated broker-dealers, affiliated ATSs, or market centers that provide routing inducements, such as PFOF from wholesale market makers and exchange liquidity rebates.

Targeted Reviews of Wholesale Market Makers

FINRA is conducting targeted best execution reviews of wholesale market makers concerning their relationships with broker-dealers that route orders to them as well as their own order routing practices and decisions (with respect to these orders). These targeted reviews are evaluating:

- whether wholesale market makers are conducting adequate execution quality reviews;
- whether order routing, handling and execution arrangements (including PFOF agreements) with retail broker-dealers have an impact on the wholesale marker makers' order handling practices and decisions, and fulfillment of their best execution obligations; and
- any modified order handling procedures that the wholesale market makers implemented during volatile or extreme market conditions.

Effective Practices:

- **Exception Reports** – Using exception reports and surveillance reports to support firms' efforts to meet their best execution obligations.
- **PFOF Order Handling Impact Review** – Reviewing how PFOF affects the order-handling 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 or more frequent basis (such as monthly), depending on the firm's business model.
- **Continuous Updates** – Updating WSPs and best execution analysis to address market and technology changes.

Additional Resources

- ***Regulatory Notice* 21-23 (FINRA Reminds Member Firms of Requirements Concerning Best Execution and Payment for Order Flow)**
- ***Regulatory Notice* 21-12 (FINRA Reminds Member Firms of Their Obligations Regarding Customer Order Handling, Margin Requirements and Effective Liquidity Management Practices During Extreme Market Conditions)**
- *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)
- FINRA Report Center
- Equity Report Cards
- Best Execution Outside-of-the-Inside Report Card

Disclosure of Routing Information NEW FOR 2022

Regulatory Obligations and Related Considerations

Regulatory Obligations:

Rule 606 of Regulation NMS requires broker-dealers to disclose information regarding the handling of their customers' orders in NMS stocks and listed options. These disclosures are designed to help customers: better understand how their firm routes and handles their orders; assess the quality of order handling services provided by their firm; and ascertain whether the firm is effectively managing potential conflicts of interest that may impact their firm's routing decisions.

Related Considerations:

- Does the firm publish accurate, properly formatted quarterly routing reports on its website for the required retention period as specified under Rule 606(a), including use of the SEC's most recently published PDF and XML schema?
- If the firm is not required to publish a quarterly report under Rule 606(a), does the firm have an effective supervisory process to periodically confirm that the firm has no orders subject to quarterly reporting?
- If the firm routes orders to non-exchange venues, does the firm adequately assess whether such venues are covered under Rule 606(a)?
- If the firm routes orders to non-exchange venues, does the firm obtain and retain sufficient information from such venues to properly report the material terms of its relationships with such venues, including specific quantitative and qualitative information regarding PFOF and any profit-sharing relationship?
- If the firm claims an exemption from providing not held order reports under Rule 606(b)(3) pursuant to Rule 606(b)(4) or (5), what policies and procedures does the firm have in place to determine if the firm's or a customer's order activity falls below the relevant *de minimis* thresholds?
- If the firm is required to provide customer-specific disclosures under Rule 606(b)(3), does the firm provide accurate, properly formatted disclosures for the prior six months to requesting customers within seven business days of receiving the request?

Exam Findings and Effective Practices

Exam Findings:

- **Inaccurate Quarterly Reports** – Publishing inaccurate information in the quarterly report on order routing, such as:
  - reporting only held orders in listed options, instead of both held and not held orders;
  - incorrectly stating that the firm does not have a profit-sharing arrangement or receive PFOF from execution venues;
  - not including payments, credits or rebates (whether received directly from an exchange or through a pass-through arrangement) in the "Net Payment Paid/Received" and "Material Aspects" sections of the quarterly report;
  - not including exchange pricing arrangements (*e.g.,* tiered pricing) in the "Net Payment Paid/Received" and "Material Aspects" sections of the quarterly report;
  - not disclosing any amounts of "Net Payment Paid/Received", when the firm receives PFOF for at least one of the four order types (*i.e.,* Market Orders, Marketable Limit Orders, Non-Marketable Limit Orders, Other Orders);
  - inaccurately identifying reported execution venues as "Unknown";
  - inaccurately identifying firms as execution venues (*e.g.,* identifying routing broker-dealer as execution venue, rather than the exchange where transactions are actually executed);

- incorrectly listing an entity as an execution venue when that entity does not execute trades (*e.g.,* firm that re-routes, but does not execute, orders; options consolidator that does not provide liquidity); and
- not posting the quarterly report on their firm's website in both required formats (*i.e.,* PDF and XML schema).

- **Incomplete Disclosures** – Not adequately describing material aspects of their relationships with disclosed venues in the Material Aspects disclosures portion of the quarterly report, such as:
  - inadequate descriptions of specific terms of PFOF and other arrangements (*e.g.,* "average" amounts of PFOF rather than specific disclosure noting the payment types, specific amount received for each type of payment, terms and conditions of each type of payment);
  - ambiguous descriptions of receipt of PFOF (*e.g.,* firm "may" receive payment);
  - inadequate or incomplete descriptions of PFOF received through pass-through arrangements;
  - incomplete descriptions of exchange credits or rebates; and
  - incomplete descriptions of tiered pricing arrangements, including the specific pricing received by the firm.
- **Deficient Communications** – Not notifying customers in writing of the availability of information specified under Rule 606(b)(1), as required by Rule 606(b)(2).[15]
- **Insufficient WSPs** – Either not establishing or not maintaining adequate WSPs reasonably designed to achieve compliance with the new requirements of Rule 606, including:
  - not updating their Disclosure of Order Routing Information WSPs to include new requirements detailed in amended Rule 606(a)(1) or new Rule 606(b)(3);
  - not describing the steps taken to review whether firms verified the data integrity of information sent to, or received from, their vendor—or not stating how the review would be evidenced by the reviewer;
  - not articulating a supervisory method of review to verify the accuracy, format, completeness, timely processing and details of the new Rule 606(b)(3) report, if requested, as well as documenting the performance of that review; and
  - not requiring the inclusion of detailed information regarding the routing and execution of the firm's customers' listed options orders in quarterly reports or customer-requested order routing disclosures.

Effective Practices:

- **Supervision** – Conducting regular, periodic supervisory reviews of the public quarterly reports and customer-specific order disclosure reports, if applicable, for accuracy (*e.g.,* assuring that per-venue disclosures of net aggregate PFOF and other payments are accurately calculated) and completeness (*e.g.,* assuring that the Material Aspects section adequately describes the firm's PFOF and other payment arrangement for each execution venue, including all material aspects that may influence the firm's order routing decisions).
- **Due Diligence on Vendors** – Performing due diligence to assess the accuracy of public quarterly reports and customer-specific order disclosure reports provided by third-party vendors by, for example, holding periodic meetings with vendors to review content of reports, comparing order samples against vendor-provided information, and confirming with the vendor that all appropriate order information is being received (particularly when the firm has complex routing arrangements with execution venues).

Additional Resources

- SEC's 2018 Amendments to Rule 606 of Regulation NMS
- SEC's Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS
- SEC's Staff Legal Bulletin No. 13A: Frequently Asked Questions About Rule 11Ac1-6
- SEC's Order Routing and Handling Data Technical Specification

Market Access Rule

Regulatory Obligations and Related Considerations

Regulatory Obligations:

Exchange Act Rule 15c3-5 (Market Access Rule) requires firms 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." **The Market Access Rule applies generally to securities traded on an exchange or alternative trading system, including equities, equity options, exchange-traded funds (ETFs), debt securities, security-based swaps, security futures products, as well as digital assets that meet the SEC's definition of a security.**

Related Considerations:

- If your firm has or provides market access, 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 market-wide 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 whether the vendor can meet the obligations of the rule?
- 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 its 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?
- **If your firm operates an ATS that has subscribers that are not broker-dealers, how does your firm comply with the requirements of the Market Access Rule, including establishing, documenting and maintaining a system of controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of this business activity?**

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, including those that transact fixed income transactions; not demonstrating the reasonability of assigned capital and credit pre-trade financial control thresholds; inadequate 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, unreasonable capital thresholds for trading desks, and unreasonable 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 or exchange, to apply their financial controls without performing adequate due diligence, not understanding how vendors' controls

operate, or both; and not maintaining direct and exclusive control over controls by allowing the ATS to unilaterally set financial thresholds for firms' fixed income orders without the involvement of the firm, 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 limits to their original values as needed.
- **Tailored Erroneous or Duplicative Order Controls** – Tailoring erroneous or duplicative order controls to particular products, situations or order types, and preventing the routing of market orders based on impact (Average Daily Volume Control) that are set at reasonable 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, potentially 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)
- FINRA's Algorithmic Trading Topic Page
- FINRA's Market Access Topic Page
- **SEC's Responses to Frequently Asked Questions Concerning Risk Management Controls for Brokers or Dealers with Market Access**

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 no less than the levels specified pursuant to the rule 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.

If firms have an affiliate paying any of their expenses, *Notice to Members* 03-63 (SEC Issues Guidance on the Recording of Expenses and Liabilities by Broker/Dealers) provides guidance for establishing an Expense Sharing Agreement that meets the standards set forth in Exchange Act Rule 17a-3[16]; firms with office leases should apply the guidance in *Regulatory Notice* 19-08 (Guidance on FOCUS Reporting for Operating Leases) for reporting lease assets and lease liabilities on their FOCUS reports. Additionally, firms must align its revenue recognition practices with the requirements of the Financial Accounting Standards Board's Topic 606 (Revenue from Contracts with Customers). ★

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 stipulations 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 sheets, 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 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

- **FASB**
  - **Revenue from Contracts with Customers (Topic 606)**
- FINRA
  - Funding and Liquidity Topic Page
  - **Interpretations to the SEC's Financial and Operational Rules**
  - ***Regulatory Notice 19-08*** **(Guidance on FOCUS Reporting for Operating Leases)**
  - *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)

Liquidity Risk 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 specified thresholds 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 and has shared observations on firms' liquidity risk management practices, as discussed in *Regulatory Notice* 15-33 (Guidance on Liquidity Risk Management Practices) and *Regulatory Notice* 21-12 (FINRA Reminds Member Firms of Their Obligations Regarding Customer Order Handling, Margin Requirements and Effective Liquidity Management Practices During Extreme Market Conditions). Additionally, FINRA has adopted a new filing requirement—the Supplemental Liquidity Schedule—for firms with large customer and counterparty exposures. As noted in *Regulatory Notice* 21-31 (FINRA Establishes New Supplemental Liquidity Schedule (SLS)), the new SLS is designed to improve FINRA's ability to monitor for potential adverse changes in these firms' liquidity risk.

Related Considerations:

- What departments at your firm are responsible for liquidity management?
- How often does your firm review and adjust its assumptions regarding clearing deposits in its liquidity management plan and stress test framework?
- **Does your firm's liquidity management practices include processes for:**
  - **accessing liquidity during common stress conditions—such as increases in firm and client activities—as well as "black swan" events;**
  - **determining how the funding would be used; and**
  - **using empirical data from recent stress events to increase the robustness of its stress testing?**
- Does your firm's contingency funding plan take into consideration the amount of time needed to address margin calls from both customers and counterparties? Does your firm also take into consideration the type of transactions that are impacting the firm's liquidity?
- What kind of stress tests (*e.g.,* market or idiosyncratic) does your firm conduct? Do these tests include concentration limits within securities or sectors, and incorporate holdings across accounts held at other financial institutions?

Exam Observations and Effective Practices

Exam Observations:

- **Not Modifying Business Models** – Failing to incorporate the results of firms' stress tests into their business model.
- **Establishing Inaccurate Clearing Deposit Requirements – Incorrectly basing clearing deposit requirements on information that doesn't accurately represent their business operations (*e.g.,* using the amounts listed on FOCUS reports rather than spikes in deposit requirements that may have occurred on an intra-month basis).**
- **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 and the process for accessing liquidity during a stress event, as well as 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 condition and stressed conditions;
    - assumptions based on idiosyncratic and market-wide conditions;
    - early warning indicators and escalation procedures if risk limits are neared or breached; and
    - **material changes in market value of firm inventory over a short period of time.**
- **Stress Tests** – Conducting stress tests in a manner and frequency that consider the complexity and risk of the firm's business model, including:
  - assumptions specific to the firm's business (*e.g.,* increased haircuts on collateral pledged by firm, availability of funding from a parent firm) and based on historical data;
  - the firm's sources and uses of liquidity, and if these sources can realistically fund its uses in a stressed environment;
  - the potential impact of off-balance sheet items (*e.g.,* non-regular way settlement trades, forward contracts) on liquidity; and
  - periodic governance group review of stress tests.

Additional Resources

- ***Regulatory Notice* 21-31 (FINRA Establishes New Supplemental Liquidity Schedule (SLS))**
- ***Regulatory Notice* 21-12 (FINRA Reminds Member Firms of Their Obligations Regarding Customer Order Handling, Margin Requirements and Effective Liquidity Management Practices During Extreme Market Conditions)**
- *Regulatory Notice* 15-33 (Guidance on Liquidity Risk Management Practices)
- *Regulatory Notice* 10-57 (Funding and Liquidity Risk Management Practices)
- FINRA's Funding and Liquidity Topic Page

Credit Risk Management

Regulatory Obligations and Related Considerations

Regulatory Obligations:

FINRA has consistently reminded firms of the importance of properly managing credit risk and published *Notices* that offer guidance on effective funding and liquidity risk management practices (which are available in the "Additional Resources" section below). Risk exposures can arise from clearing arrangements, prime brokerage arrangements (especially fixed income prime brokerage), "give up" arrangements and sponsored access arrangements (discussed in the Market Access Rule section).

Further, firms should maintain a control framework where they manage credit risk and 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. In particular, Exchange Act Rule 17a-3(a)(23) requires firms that meet specified thresholds 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.

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 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

- *Regulatory Notice* 21-31 (FINRA Establishes New Supplemental Liquidity Schedule (SLS))
- *Regulatory Notice* 21-12 (FINRA Reminds Member Firms of Their Obligations Regarding Customer Order Handling, Margin Requirements and Effective Liquidity Management Practices During Extreme Market Conditions)
- FINRA's 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 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 delivering them 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 that 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 assure compliance with the Customer Protection Rule? Has the firm analyzed these controls and procedures to address potential concerns arising from acting 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:

- **Confirming Control Agreements** – 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 include 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 Asset Securities by Special Purpose Broker-Dealers, Exchange Act Release No. 34-90788 (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)

Portfolio Margin and Intraday Trading NEW FOR 2022

Regulatory Obligations and Related Considerations

Regulatory Obligations:

FINRA Rule 4210(g) (Margin Requirements) permits member firms to apply portfolio margin requirements—based on the composite risk of a portfolio's holdings—in margin accounts held by certain investors as an alternative to "strategy-based" margin requirements. Firms are required to monitor the risk of the positions held in these accounts during a specified range of possible market movements according to a comprehensive written risk methodology.

Related Consideration:

- Do the firm's policies and procedures for monitoring the risk of their investors' portfolio margin accounts comply with Rule 4210(g)(1), in particular:
  - maintaining a comprehensive written risk methodology for assessing the potential risk to the member's capital during a specified range of possible market movements of positions maintained in such accounts;
  - monitoring the credit risk exposure of portfolio margin accounts both intraday and end of day; and
  - maintaining a robust internal control framework reasonably designed to capture, measure, aggregate, manage, supervise and report credit risk exposure to portfolio margin accounts?

Exam Findings and Effective Practices

Exam Findings:

- **Inadequate Monitoring Systems** – Systems not designed to consistently identify credit risk exposure intra-day (*e.g.,* do not include defined risk parameters required to produce notifications or exceptions reports to senior management; require manual intervention to run effectively) or end of day (*e.g.,* cannot monitor transactions executed away in a timely manner).
- **Not Promptly Escalating Risk Exposures** – Staff failing to promptly identify and escalate incidents related to elevated risk exposure in portfolio margin accounts to senior management, in part due to insufficient expertise.
- **Insufficient WSPs** – Failing to maintain written supervisory procedures outlining intraday monitoring processes and controls.

Effective Practices:

- **Internal Risk Framework** – Developing and maintaining a robust internal risk framework to identify, monitor and aggregate risk exposure within individual portfolio margin accounts and across all portfolio margin accounts, including:
  - increasing house margin requirements during volatile markets in real-time;
  - conducting stress testing of client portfolios;
  - closely monitoring client fund portfolios' NAV, capital, profitability, client redemptions, liquidity, volatility and leverage to determine if higher margin requirements or management actions are required; and
  - monitoring and enforcing limits set by internal risk functions and considering trigger and termination events set forth in the agreement with each client.
- **Concentration Risk** – Maintaining and following reasonably designed processes (reflected in the firm's WSPs) and robust controls to monitor the credit exposure resulting from concentrated positions within both individual portfolio margin accounts and across all portfolio margin accounts, including processes to:
  - aggregate and monitor total exposure and liquidity risks with respect to accounts under common control;
  - identify security concentration at the aggregate and single account level; and
  - measure the impact of volatility risk at the individual security level.
- **Client Exposure** – Clearly and proactively communicating with clients with large or significantly increasing exposures, according to clearly delineated triggers and escalation channels established by the firm's WSPs; and requesting that clients provide their profit and loss position each month.

Additional Resource

- FINRA's Portfolio Margin FAQ

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

Firms 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 and effective practices noted in our Reports and determined whether their compliance programs have any gaps that could lead to the types of findings noted in those 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.

Endnotes

1. "Related Considerations" are intended to serve as a possible starting point in considering a firm's compliance program related to a topic. Firms should review relevant rules to understand the full scope of their obligations.
2. "Nesting" refers to FFIs indirectly gaining access to the U.S. financial system through another FFI's correspondent account at a U.S. financial institution. This practice can facilitate legitimate financial transactions, but member firms that maintain correspondent accounts with FFIs should have policies and procedures to identify and monitor for potentially illegitimate "nested" activity.
3. An IP address is a unique identifier assigned to an Internet-connected device, while a MAC is a unique identifier used to identify a specific hardware device at the network level.
4. *See Regulatory Notice 21-18* (FINRA Shares Practices Firms Use to Protect Customers From Online Account Takeover Attempts)
5. *See Regulatory Notice 20-13* (FINRA Reminds Firms to Beware of Fraud During the Coronavirus (COVID-19) Pandemic)
6. The SEC is proposing amendments to 17a-4 to allow for electronic records to be preserved in a manner that permits the recreation of an original record if it is altered, over-written, or erased. *See* the SEC's Proposed Rule: Electronic Recordkeeping Requirements for Broker-Dealers, Security-Based Swap Dealers, and Major Security-Based Swap Participants.
7. These regulatory obligations stem from Exchange Act Rule 15c3-3(d)(4) and MSRB Rules G-17 and G-27 (for firm shorts), and MSRB Rule G12-(h) (for fails-to-receive).
8. Reg BI also applies to certain recommendations that were not previously covered under suitability obligations (*e.g.,* account recommendations, implicit hold recommendations in the case of agreed-upon account monitoring).
9. When a retail customer opens or has an existing account with a broker-dealer, the retail customer has a relationship with the broker-dealer and is therefore in a position to "use" the broker-dealer's recommendation.
10. While the SEC presumes that the use of the term "adviser" or "advisor" in a name or title by an associated person of a broker-dealer who is not also a supervised person of an investment adviser is a violation of the Disclosure Obligation under Reg BI, it recognizes that usage may be appropriate under certain circumstances. *See* FINRA's Reg BI and Form CRS Checklist for examples of possible exceptions.
11. *See* the SEC's December 17, 2021 Staff Statement Regarding Form CRS Disclosures for additional observations.
12. *Regulatory Notice 21-10* summarized the recent updates to the 5122/5123 Notification Filing Form that became effective on May 22, 2021, and *Regulatory Notice 21-26* announced that, as of October 1, 2021, FINRA Rules 5122 and 5123 require member firms to file retail communications that promote or recommend a private placement offering that is subject to these rules' filing requirements with FINRA's Corporate Financing Department.
13. *See* CAT NMS Plan, FAQ R.2 for the types of information firms should obtain from third-party vendors to satisfy these requirements.
14. *See, e.g., Regulatory Notice 21-23*.
15. In addition to the order routing disclosures under Rule 606, Rule 607 of Regulation NMS requires firms to disclose their policies regarding PFOF and order routing when customers open accounts, and on an annual basis thereafter, so firms should consistently provide the same information in both types of disclosures.
16. Firms are reminded that any affiliate obligated to pay firm expenses must have the independent financial means to satisfy those obligations.

www.finra.org

22_0021.1—02/22

Regulatory Notice 21-18

Cybersecurity

FINRA Shares Practices Firms Use to Protect Customers From Online Account Takeover Attempts

Summary

FINRA has received an increasing number of reports regarding customer account takeover (ATO) incidents, which involve bad actors using compromised customer information, such as login credentials (*i.e.,* username and password), to gain unauthorized entry to customers' online brokerage accounts.

To help firms prevent, detect and respond to such attacks, FINRA recently organized roundtable discussions with representatives from 20 firms of various sizes and business models to discuss their approaches to mitigating the risks from ATO attacks.

This *Notice* outlines the recent increase in ATO incidents; reiterates firms' regulatory obligations to protect customer information; and discusses common challenges firms identified in safeguarding customer accounts against ATO attacks, as well as practices they find effective in mitigating risks from ATOs—including recent innovations—which firms may consider for their cybersecurity programs.

This *Notice* does not create new legal or regulatory requirements, or new interpretations of existing requirements. A firm's cybersecurity program should be reasonably designed and tailored to the firm's risk profile, business model and scale of operations. There should be no inference that FINRA requires firms to implement any specific practices described in this *Notice*.

Questions regarding this *Notice* should be directed to:

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

May 12, 2021

Notice Type

- Special Alert

Suggested Routing

- Compliance
- Information Technology
- Legal
- Operations
- Risk Management
- Senior Management

Key Topics

- Access Control
- Authentication
- Cybersecurity
- Fraud

Referenced Rules & Notices

- FINRA Rule 2090
- FINRA Rule 3110
- FINRA Rule 3310
- FINRA Rule 4512
- Information Notice 10/15/20
- Notice to Members 05-48
- Regulatory Notice 20-13
- Regulatory Notice 20-30
- Regulatory Notice 20-32

Background and Discussion

FINRA has received an increasing number of reports regarding ATO incidents, which involve bad actors using compromised customer information, such as login credentials, to gain unauthorized entry to customers' online brokerage accounts. In addition, we have received reports regarding attackers using synthetic identities to fraudulently open new accounts; some of the information addressed here, particularly regarding the opening of online accounts, may help firms mitigate risks in this area.[1]

Customer ATOs have been a recurring issue, but reports to FINRA about such attacks have increased as more firms offer online accounts, and more investors conduct transactions in these accounts, in part due to the proliferation of mobile devices and applications (*i.e.,* "apps")[2] and the reduced accessibility of firm's physical locations due to the COVID-19 pandemic.

Bad actors have taken advantage of these conditions to attempt customer ATOs, often through common attack methods such as phishing emails and social engineering attempts (*e.g.,* fraudsters calling customers, pretending to be registered representatives from customers' firms to acquire their personal information).[3] Other reasons for this increase in attempts may include the large number of stolen customer login credentials available for sale on the "dark web" (*see* Appendix for definitions of cybersecurity terms used in this *Notice*) and the emergence of more sophisticated ATO methods, such as tools that automate ATO attacks at scale (*e.g.,* using mobile emulators to mimic mobile devices that have been compromised to access thousands of online brokerage accounts).

Password Managers for Customer Account Protection

Some firms observed that customers often use the same login information across multiple accounts, making them particularly susceptible to ATOs conducted on a widescale (*e.g.,* credential stuffing).

To mitigate this threat, some firms recommend that customers use a password manager—an application that protects online accounts by suggesting and saving individual, strong passwords for each login. The password manager then automatically fills in the password whenever customers access their accounts online.

Regulatory Obligations

FINRA reminds member firms of their obligations to protect sensitive customer data, as well as verify the identity and know the essential facts concerning every customer:

Regulatory Obligation	Summary
FINRA Rule 2090 (Know Your Customer)	Firms must use reasonable diligence, in regard to the opening and maintenance of every account, to know the "essential facts" concerning every customer. Essential facts are those required to: (1) effectively service the customer's account; (2) act in accordance with any special handling instructions for the account; (3) understand the authority of each person acting on behalf of the customer; and (4) comply with applicable laws, rules and regulations.
SEC Regulation S-P, Rule 30	Firms must have written policies and procedures that address administrative, technical and physical safeguards for the protection of customer records and information that are reasonably designed to ensure the security and confidentiality of customer records and information; protect against any anticipated threats or hazards to the security or integrity of customer records and information; and protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer.
SEC Regulation S-ID	Firms must develop and implement a written program to detect, prevent and mitigate identity theft in connection with the opening or maintenance of "covered accounts."[4] In designing those programs, firms should consider, among other things, the methods of accessing covered accounts and the detection of red flags of identity theft in connection with authenticating customers.
Customer Identification Program (CIP)	Firms' anti-money laundering compliance programs must establish, document and maintain a written Customer Identification Program (CIP).[5] Among other requirements, firms' CIPs must include risk-based procedures that enable firms to form a reasonable belief that they know the true identity of each person that opens a new account. These procedures must be based on an assessment of the relevant risks, including those presented by the various types of accounts maintained by the firm and the various methods of opening accounts.[6] The CIPs must also describe when they will use documentary, non-documentary or a combination of both methods for identity verification.[7]

FINRA also encourages firms to assess their compliance programs related to new account openings and funds transfers, and review their policies and procedures related to:

- confirming that new account openings comply with FINRA Rule 4512 (Customer Account Information), as well as the Bank Secrecy Act and its implementing regulations addressed under FINRA Rule 3310 (Anti-Money Laundering Compliance Program);
- handling of ACH and other transmittal requests to "determine the authenticity of transmittal instructions" obligations pursuant to FINRA Rule 3110 (Supervision); and
- filing Suspicious Activity Reports (SARs)[8] with FinCEN.[9]

Common Challenges to Protecting Customer Accounts

During the roundtable discussions with FINRA, firms discussed the following cybersecurity challenges[10] they have encountered when safeguarding customer accounts from ATOs:

- identifying effective methods of verifying the identities of customers who establish accounts online;[11]
- addressing increased volume of attempted customer ATOs;
- preventing bad actors from transferring money in and out of customer accounts;
- identifying when bad actors have taken over customer accounts by modifying customers' critical account information (*e.g.,* email address, bank information) and are attempting fraudulent transactions;
- identifying when login attempts and requests to reset account passwords are actually made by a bad actor who has taken over a customer's email account; and
- balancing security and customer experience considerations.

Noted Practices

During the roundtable, firms discussed a variety of policies, procedures, controls and related tools to mitigate ATO-related risks. The firms typically used a risk-based approach to validating new customers' identities, authenticating logins to firm systems and performing customer-requested actions (*e.g.,* transactions in an account), coupled with strong back-end monitoring and robust procedures to respond quickly to identified customer ATOs.

Verifying Customers' Identities When Establishing Online Accounts

As part of their cybersecurity programs, firms that onboard customers online verified potential customers' identities by:

- validating identifying information or documents that applicants provide (*e.g.,* Social Security number (SSN), address, driver's license), including, for example, through "likeness checks"; and

- asking applicants follow-up questions or requesting additional documents to validate their identities, based on information from credit bureaus, credit reporting agencies or firms providing digital identity intelligence (*e.g.,* automobile and home purchases).

Alternatively, some firms contracted with third-party vendors to perform the above functions, as well as provide additional support (*e.g.,* a database to verify the legitimacy of suspicious information in customers' applications).[12]

Authenticating Customers' Identities During Login Attempts

Firms took a variety of approaches to validating the identities of customers when they access their online accounts:

Multifactor authentication: Most firms embraced multifactor authentication (MFA) as a key control that significantly reduces the likelihood that bad actors can take over a customer's account. Some of these firms required all customers to use MFA; others required customers to use MFA if their account had been compromised, while others simply encouraged customers to adopt it.

Key takeaway: *While not a "silver bullet," most participants believe MFA is currently one of the best ways to protect customers' accounts from ATOs.*

Unlike single-factor authentication (*e.g.,* a password), MFA uses two or more different types of factors or secrets—such as a password and code sent via a Short Message Service (SMS) text message or an authentication app—which significantly reduces the likelihood that the exposure of a single credential will result in account compromise.[13] A number of firms are encouraging customers to adopt MFA by establishing streamlined MFA methods, such as customers entering their login credentials on trusted devices.

Adaptive authentication: Some firms use adaptive authentication techniques to further increase the security of customers' accounts. Adaptive authentication typically assesses both:

- the risk associated with a customer's login (*i.e.,* the authentication system's confidence in the customer's identity, based on various factors associated with the login attempt (such factors are discussed further below)); and
- the risk of the activity the customer wishes to perform (*e.g.,* checking an account balance or initiating a money transfer).

In situations where the authentication system assesses that at least one of these risks exceeds a certain risk threshold, the system will require the customer to provide additional information to confirm their identity. For example, a customer may be required to provide additional information to verify their identity if they:

- attempt to log in to their account from a new device or different location than usual; or
- seek to execute a higher risk transaction such as an abnormally large withdrawal or purchase of a different type of security (*e.g.,* a low-priced unlisted security) than usual, or change a bank account or email address associated with their account.

A risk threshold can be set in a variety of ways. For example, a firm may set relatively simple rules (*e.g.,* transactions exceeding a specific dollar value or percent of account size). Alternatively, a firm may establish policies that assess a broad range of factors to determine whether additional verification is required.

Supplemental authentication factors: There are a variety of factors that firms and vendors may incorporate into their authentication system and processes to verify a customer's identity, including:

- SMS text message codes;
- phone call verifications;
- media access control (MAC) addresses;
- geolocation information;
- third-party authenticator apps; and
- biometrics.

In addition, many firms noted they have transitioned away from using email addresses as authentication factors, due to the prevalence of email account breaches by bad actors.

Back-End Monitoring and Controls

Firms conducted ongoing surveillance of both individual customer accounts and across these accounts to prevent, detect and mitigate ATO threats. (In some cases, the results of such back-end monitoring may feed back into firms' front-end controls.) This included, for example:

- monitoring at the customer account level for anomalies, such as:
  - indications of ATO attempts at the login level (*e.g.,* significant increases in number of failed logins in a brief time period for a specific account); and
  - account activity that could indicate that an ATO has occurred (*e.g.,* large purchases shortly after account opening; changes in email account of record followed by a request for a third-party wire; frequent transfers of funds in and out of an account);

- monitoring across customers' accounts for indications of credential stuffing or other large-scale attacks (*e.g.,* significant increases in the number of login attempts and failed logins across a large number of accounts);
- monitoring emails received from customers for red flags of social engineering (*e.g.,* problems with grammar or spelling; unexpected attachments, apps or links);[14]
- establishing back-end controls to prevent bad actors from moving money out of customer accounts, such as requiring a confirmation phone call with the customer using an established phone number when suspicious activity is detected in their account (*e.g.,* withdrawing money from an online brokerage account into a newly-established bank account); and
- scanning the dark web for keywords or data that could be useful to bad actors in facilitating an ATO (*e.g.,* firm name, customer account numbers, names of firm executives, planted accounts and passwords).

Procedures for Potential or Reported Customer ATOs

Firms discussed methods to proactively address potential or reported customer ATOs by:

- establishing a dedicated fraud group to investigate customer ATOs;
- responding promptly and effectively to customers who report ATOs, frequently updating them on their account status and minimizing the amount of time their accounts are locked or their trading ability is suspended;
- reviewing all of a customer's accounts at the firm for signs of problematic activity, if such activity is identified in one of their accounts;
- providing a method for customers to quickly communicate with someone at the firm, typically through voice or chat channels in a contact center; and
- reminding customers of recommended security practices (*e.g.,* MFA adoption).

Automated Threat Detection

Firms used a variety of automated processes to detect potential malicious actions by bad actors, for example, by:

- using web application firewalls (WAFs) and internally built tools to stop credential stuffing attacks;
- isolating suspicious IPs in a "penalty box"; and
- instituting geographic-based controls (*e.g.,* "impossible travel" or disallowing connections from countries where no customers reside).

Restoring Customer Account Access

Firms noted that secure practices to restore customers' account access—whether because a customer has forgotten their password or because they are otherwise locked out—in a timely fashion are essential. At the same time, however, the process must be well thought out and incorporate appropriate safeguards so that it does not itself become an avenue for ATOs. Practices firms noted in this regard included:

- implementing two-factor authentication for all password resets, for example, requiring input of a time-sensitive code sent to investors by SMS text message (several firms noted that sending a code via email can be risky because customers' email accounts may have been compromised, so firms using this approach may want to ask for additional confirming information, as described in the bullet below); and
- requiring customers to contact call centers, and answer security questions based on less commonly available information (*i.e.,* information less likely to be available through the dark web or a customer's social media posts, and provided by the credit bureaus or firms providing digital identity intelligence) to restore their account access.

Investor Education

Firms noted that they educated and trained their customers on account security by:

- including cybersecurity-related materials in the client onboarding process;
- providing up-to-date cybersecurity information;
- including on the firm's website resources—such as alerts—that customers can opt in to receiving, such as email or SMS text messages for certain types of account activity; and
- adding educational content to statements of older investors.

Reporting Fraud

FINRA urges firms to protect customers and other firms by immediately reporting scams and any other potential fraud to:

- FINRA's Regulatory Tip Form found on FINRA.org;
- U.S. Securities and Exchange Commission's tips, complaints and referral system (TCRs) or by phone at (202) 551-4790;
- the Federal Bureau of Investigation's (FBI) tip line at 800-CALLFBI (225-5324) or a local FBI office;
- the Internet Crime Compliant Center (IC3) for cyber-crimes (particularly if a firm is trying to recall a wire transfer to a destination outside the United States); and
- local state securities regulators.[15]

In addition, firms should consider whether circumstances require that the firm file a SAR[16] or report pursuant to FINRA Rule 4530 (Reporting Requirements).[17]

Conclusion

As noted herein, FINRA has received reports that the prevalence and sophistication of customer ATOs have been increasing. In the face of this threat, firms have implemented a variety of policies, procedures, controls and related tools to prevent, detect and respond to ATOs. FINRA shares practices roundtable participants found to be effective to help other firms mitigate ATO risks. Additional information related to cybersecurity risk management can be found on FINRA's Cybersecurity Topic Page.

Appendix

The following list defines commonly-used cybersecurity terms that appear in this *Notice*:

Biometrics – the unique physical identifiers (*e.g.,* fingerprint, voice and facial recognition) or behavioral characteristics (*e.g.,* mouse activity and keyboard strokes on computers; touchscreen behavior and device movement on mobile devices) humans display to digitally authenticate their identity.
Credential Stuffing – a cyberattack in which a bad actor uses a large set of illegally-acquired usernames and passwords to attempt to gain unauthorized access to multiple user accounts.
Dark Web – the portion of the Internet that can only be accessed through special types of software and is often used to anonymously conduct illegal activity.
Impossible Travel – a security control that compares the locations of a user's most recent two sign-in attempts to determine if travel between those locations was impossible in the timeframe given (*e.g.*, logging in from Cleveland, Ohio and then, twenty minutes later, from Salt Lake City, Utah).
Likeness Check – an identity verification method where applicants upload a photo or video of themselves, which is then compared with their recently submitted identity documents (and, at times, voice recordings).
Media Access Control (MAC) – a unique identifier used to identify a specific hardware device at the network level.
Penalty Box – a tool that isolates Internet Protocol (IP) addresses that exhibit potentially malicious behavior.
Planted Account – a fake account established by a firm within its customer database. In the context of cybersecurity, firms often monitor the dark web for information related to planted accounts to uncover data breaches.
Short Message Service (SMS) – a system for sending short messages (*e.g.,* text) over a wireless network.
Trusted Device – a device frequently used by a customer to access their online account, such as a mobile phone, tablet or home computer. A customer can designate a device as "trusted" on the Verification Code screen by clicking the box next to "Don't ask again on this computer".
Web Application Firewall (WAF) – a firewall that monitors traffic between a web application and the Internet and filters out any malicious traffic (as defined by its set of policies).

Endnotes

1. *See* Regulatory Notice 20-32 (FINRA Reminds Firms to Be Aware of Fraudulent Options Trading in Connection With Potential Account Takeovers and New Account Fraud) for definitions of ATOs and synthetic identities.

2. *See* FINRA's 2018 Report on Selected Cybersecurity Practices for effective practices firms have implemented to protect sensitive firm and customer information as the use of mobile devices expands and becomes more widespread.

3. *See* Regulatory Notice 20-30 (Fraudsters Using Registered Representatives Names to Establish Imposter Websites).

4. *See* 17 CFR 248.201(b)(3), which defines "covered account" as:

   (i) An account that a financial institution or creditor offers or maintains, primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions, such as a brokerage account with a broker-dealer or an account maintained by a mutual fund (or its agent) that permits wire transfers or other payments to third parties; and

   (ii) Any other account that the financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks.

5. *See* 31 C.F.R. 1023.220 and 31 C.F.R. 1023.100(d). Pursuant to FINRA Rule 3310(b), firms must establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and its implementing regulations, including the CIP Rule.

6. *Ibid.*

7. *See* 31 C.F.R. 1023.220(a)(2)(ii). For firms relying on documents to verify identity, the documents utilized may include an original unexpired government-issued identification evidencing nationality or residence and bearing a photograph, such as a driver's license or passport. Non-documentary methods of verifying customer identity under the CIP Rule may include contacting a customer; independently verifying the customer's identity through comparison of the information the customer provides with information from a consumer reporting agency, public database, or other source; checking references with other financial institution; or obtaining a financial statement.

8. *See* 31 C.F.R. 1023.320 for SARs reporting requirements.

9. *See* FinCEN's July 2020 Advisory on Cybercrime and Cyber-Enabled Crime Exploiting the Coronavirus Disease 2019 (COVID-19) Pandemic for additional guidance on filing SARs.

10. The challenges discussed in this *Notice* may require firms to address regulatory obligations beyond the context of cybersecurity—for example, those related to anti-money laundering compliance programs.

11. *See* FinCEN's July 2020 Advisory and *Regulatory Notice 20-13* (FINRA Reminds Firms to Beware of Fraud During the Coronavirus (COVID-19) Pandemic) for recent, common tactics bad actors use to establish fraudulent customer accounts.

12. Outsourcing an activity or function to a third party does not relieve firms of their ultimate responsibility for compliance with all applicable securities laws and regulations and FINRA and MSRB rules regarding the outsourced activity or function. FINRA has provided substantial guidance regarding firms' responsibilities when outsourcing activities to third-party service providers. *See, e.g.,* *Notice to Members 05-48* (Members' Responsibilities When Outsourcing Activities to Third-Party Service Providers).

13. *See* *Information Notice 10/15/20* (Cybersecurity Background: Authentication Methods) for a primer on authentication techniques for firms to consider implementing within their cybersecurity programs.

14. *See* FINRA's 2018 Cybersecurity Report for additional effective practices firms have implemented to mitigate the threat of phishing attacks.

15. *See* North American Securities Administrations Association's Contact Your Regulator.

16. *See supra* note 9. *See also* FinCEN's Frequently Asked Questions (FAQs) regarding the Reporting of Cyber-Events, Cyber-Enabled Crime, and Cyber-Related Information through Suspicious Activity Reports (SARs).

17. For additional information about the requirements of FINRA Rule 4530 (Reporting Requirements), *see* Rule 4530 Frequently Asked Questions.

2022 Annual Conference

May 16 –18 | Washington, DC | Hybrid Event

Senior and At-Risk Investors
Monday, May 16, 2022
11:15 a.m. – 12:15 p.m.

Join FINRA staff and industry practitioners as they discuss legal and regulatory tools and effective practices to assist firms and financial professionals in serving and protecting senior and other at-risk investors.

Moderator:

Jeanette Wingler
Associate General Counsel, Regulatory
FINRA Office of General Counsel

Panelists:

Brooke Hickman
Director, Vulnerable Adults & Seniors Team
FINRA Member Supervision

Thomas Mierswa
Executive Director
Morgan Stanley

Joel Sauer, CFA
Director of Senior and Vulnerable Investor Investigations
Charles Schwab & Co., Inc.

Jennifer Szaro, CRCP®
Chief Compliance Officer
XML Securities, LLC

Senior and At-Risk Investors Panelists Bios:

Moderator:

Jeanette Wingler is Associate General Counsel in FINRA's Office of the General Counsel. Ms. Wingler's responsibilities involve a variety of regulatory areas, including research analyst conflicts, cybersecurity, seniors and other vulnerable investors and recruitment practices. Prior to joining FINRA in 2014, Ms. Wingler was an associate at Dechert LLP, where she advised on regulatory and compliance matters for broker-dealers, investment advisers and investment companies. Ms. Wingler graduated from the University of North Carolina at Chapel Hill with a bachelor's degree in political science and history. She has a law degree from Duke University School of Law.

Panelists:

Brooke Hickman is Director of FINRA's Vulnerable Adults and Seniors Team ("VAST"). The mission of the Vulnerable Adults & Seniors Team is to deter, detect, and investigate the financial exploitation and abuse of seniors and vulnerable adults. Prior to joining VAST, Mrs. Hickman was a Cycle Examiner with FINRA's Member Regulation Department in the Boca Raton District Office. Before coming to FINRA, she worked in the industry as a Financial Advisor and then in Operations at a large mutual fund company. Mrs. Hickman has undergraduate and graduate degrees in International Business.

Tom Mierswa, is Executive Director in the Branch Advisory Group of the Legal and Compliance Division of Morgan Stanley. He started his career on Wall Street as a senior litigation counsel, later turning to retail advisory law, which is his practice today. A graduate of Williams College and American University's Washington College of Law, before joining Wall Street, Mr. Mierswa clerked on the District of Columbia Court of Appeals and served as an Assistant District Attorney and Senior Investigative Counsel in the New York County District Attorney's Office under Robert M. Morgenthau. He has been an adjunct professor of law at Fordham University Law School, sits periodically as a FINRA arbitrator, is an active member of SIFMA's Senior Investor's Working Group and frequently presents on industry issues arising from the handling of accounts of senior investors.

Joel Sauer joined Charles Schwab as the Director of Senior and Vulnerable Investor (SVI) Investigations in 2019. He began his financial services career as an Investigator and Assistant Director in Inspections and Compliance at the Texas State Securities Board. He then served as an Examiner and Examinations Branch Chief in the Fort Worth Regional Office of the U.S. Securities and Exchange Commission. Prior to joining Schwab, he was the Chief Compliance Officer for hedge fund manager Hayman Capital Management and then for private equity firm Lone Star Funds.

Jennifer Szaro is Chief Compliance Officer for XML Securities, LLC a fully disclosed introducing broker/dealer and its affiliated investment advisory firm, XML Financial Group. Ms. Szaro is responsible for managing both firms' compliance infrastructures. Ms. Szaro joined the securities industry in 2000. She previously worked in the technology sector where she had experience in ecommerce, website hosting and product development. As the securities industry went through significant changes with higher regulatory demands, she took on more compliance and marketing related roles. In 2011, she became a senior level executive and Chief Compliance Officer of the broker dealer, then dually registered. In addition to her current role as CCO, she is the AMLCO, and alternative FINOP. In 2012, she completed FINRA's Certified Regulatory and Compliance Professional Program (CRCP)®. In 2018, she became a non-public FINRA Dispute Resolution Arbitrator, having qualified through the National Arbitration and Mediation Committee. In 2019, she was appointed to serve out a two-year term on the FINRA's Small Firm Advisory Committee

(SFAC), serving as the 2020 Chair. She was re-appointed to serve a three-year term through 2023. Ms. Szaro holds the following FINRA registrations; Compliance Officer (CR), Introducing Broker-Dealer Financial and Operations Principal (FI), General Securities Principal (GP), General Securities Representative (GS), Investment Company and Variable Contracts Products Representative (IR), Municipal Securities Principal (MP), Municipal Securities Representative (MR), and Operations Professional (OS). Ms. Szaro is a graduate from the University of Rhode Island with a Bachelor of Science.

Senior and At-Risk Investors

Panelists

- **Moderator**
  - Jeanette Wingler, Associate General Counsel, Regulatory, FINRA Office of General Counsel
- **Panelists**
  - Brooke Hickman, Director, Vulnerable Adults & Seniors Team, FINRA Member Supervision
  - Thomas Mierswa, Executive Director, Morgan Stanley
  - Joel Sauer, CFA, Director of Senior and Vulnerable Investor Investigations, Charles Schwab & Co., Inc.
  - Jennifer Szaro, CRCP®, Chief Compliance Officer, XML Securities, LLC

Agenda

- FINRA Tools to Aid Customers and Firms
- Meeting Mr. Wrong, the Case of the Online Boyfriend
- The Case of the Forgotten Password
- The Case of the Would-Be Beneficiary
- Q&A
- Resources

1 | FINRA Tools to Aid Customers and Firms

FINRA Tools to Aid Customers and Firms

- **FINRA's Securities Helpline for Seniors® (1-844-57-HELPS)**
  - Launched in 2015
  - Free resource that senior investors can call to get assistance from FINRA or raise concerns about issues with brokerage accounts and investments.
  - Received over 4,000 calls since January 2021

Trusted Contact Person

- FINRA Rule 4512 (Customer Account Information) requires firms to make reasonable efforts to obtain the name of and contact information for a trusted contact person for a customer's account.
- Requires disclosure in writing to the customer that the firm or associated person is authorized to contact the trusted contact person and disclose information about the customer's account to confirm the specifics of the customer's current contact information, health status, and the identity of any legal guardian, executor, trustee or holder of a power of attorney, and as otherwise permitted by Rule 2165.
- Firms may open and maintain an account if a customer fails to identify a trusted contact person.

FINRA Rule 2165 (Financial Exploitation of Eligible Adults)

- Rule 2165 permits firms to place a temporary hold on a securities transaction or disbursement of funds or securities from the account of a "specified adult" (*i.e.*, a person 65 and older or a person 18 and older who the firm reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests) where there is a reasonable belief of financial exploitation of that customer.
- Rule 2165 provides a safe harbor under FINRA rules when a firm uses its discretion to place a temporary hold consistent with the requirements of the rule.
- A temporary hold may be placed on a particular suspicious transactions or disbursements but not on other non-suspicious transactions or disbursements.

FINRA Rule 2165 (Financial Exploitation of Eligible Adults)

- Unless a firm reasonably believes that doing so would cause further harm to a specified adult, FINRA encourages the firm to attempt to resolve a matter with a customer before placing a temporary hold.
- Temporary hold would expire not later than 15 business days.
- Provided that the firm's internal review of the facts and circumstances supports its reasonable belief of financial exploitation, Rule 2165 permits the firm to extend the temporary hold for:
  - An additional 10 business days; and
  - An additional 30 business days if the firm has reported the matter to a state regulator or agency or a court of competent jurisdiction (up to 55 business days total).
- A temporary hold may also be terminated or extended by a state regulator or agency or court of competent jurisdiction.

FINRA Rule 2165 (Financial Exploitation of Eligible Adults)

- Rule 2165 also includes important safeguards that apply equally to holds on disbursements and transactions that are designed to ensure that there is not a misapplication of the rule, including:
  - notification of the hold and rationale to all parties authorized to transact business on the account (including the customer) and the trusted contact person within two business days;
  - establishing and maintaining written supervisory procedures reasonably designed to achieve compliance with the specific requirements of the rule, including procedures related to the identification, escalation and reporting of matters related to the financial exploitation of specified adults;
  - escalating any hold request to a supervisor, compliance department or legal department rather than allowing an associated person handling an account to independently place a hold;
  - developing and documenting training policies or programs for associated persons; and
  - retaining records related to compliance with the rule, which shall be readily available to FINRA, upon request.

FINRA Rule 3241

- FINRA Rule 3241 (Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer) protects investors by requiring firms to affirmatively address registered persons being named beneficiaries or holding positions of trusts for customers. Rule 3241 does not apply where the customer is a member of the registered person's "immediate family."
- The rule defines "customer" to include any customer that has, or in the previous six months had, a securities account assigned to the registered person at any member firm.
- The rule requires the firm with which the registered person is associated, upon receiving required written notice from the registered person, to review and approve or disapprove the registered person assuming such status or acting in such capacity.
- A registered person being named as a beneficiary or to a position of trust without his or her knowledge would not violate the rule; however, the registered person must act consistent with the rule upon learning that he or she was named as a beneficiary or to a position of trust.

2 | Meeting Mr. Wrong, the Case of the Online Boyfriend

Meeting Mr. Wrong, the Case of the Online Boyfriend

Bob's client Susan is a fun-loving, senior divorcée. Susan calls Bob filled with excitement about meeting Sam. Susan is thrilled that Sam shares her love of travel, but there is one catch. Sam is short on funds to book his travel to Mexico for their joint beach vacation. Susan informs Bob that she wants to sell $10,000 in investments to pay for the vacation with Sam.

What questions should Bob ask Susan?

Meeting Mr. Wrong, the Case of the Online Boyfriend

Susan tells Bob that Sam is currently staying with his family in another state, so they have not met in person. Susan believes this beach vacation is an important step in their relationship and that Sam will pay her back once they are in Mexico. Bob is concerned that Susan is being scammed.

What steps should Bob take?

3 | The Case of the Forgotten Password

The Case of the Forgotten Password

Pam's client Bill is a retired professor. Pam receives a call from Bill asking for help after he was locked out of his account after several failed password attempts. Pam and Bill had a pleasant chat and Pam helped Bill regain access to his online account.

A few days later Pam receives another call from Bill asking for help after he was again locked out of his account after several failed password attempts. Bill does not seem to remember their prior call.

What steps should Pam consider taking?

The Case of the Forgotten Password

Over the next few months, Pam notices that Bill is increasingly confused when they speak, and his appearance has become disheveled. Bill has trouble discussing his investments or expenses.

What steps should Pam consider taking?

How might this situation have been different if Bill did not work directly with Pam and instead used the firm's call center?

4 | The Case of the Would-Be Beneficiary

The Case of the Would-Be Beneficiary

Beth supervises Dan, a recently hired RR. Dan has been meeting with his client Angela to discuss her estate planning needs. Angela has substantial assets and a strained relationship with her adult children. During their discussions, Angela told Dan that she wants to leave him a bequest as a thank you for his help. Dan is not sure what to do and asks Beth for help.

How should Beth advise Dan?

What information should the firm consider in assessing the arrangement?

The Case of the Would-Be Beneficiary

After speaking with Dan and Angela, Beth does not believe that Dan has acted improperly in seeking to become Angela's beneficiary. However, Angela has told her adult children about her estate plan and the children have expressed concern to Dan and the firm about the bequest.

How may the involvement of Angela's children factor into the firm's assessment of the arrangement?

Assume instead that, after speaking with Dan and Angela, Beth believes that Angela was improperly pressured into naming Dan as her beneficiary. How should the firm address the conduct?

Senior and At-Risk Investors

Resources

FINRA Materials

- FINRA Senior Helpline
- Protecting Senior Investors 2015-2020 Report
- FINRA *Regulatory Notice* 20-34
- FINRA *Regulatory Notice* 20-38
- FINRA *Regulatory Notice* 22-05
- Virtual Panel: Communication Between APS and Professional Reporters of Financial Exploitation
- Podcast: AML and Elder Exploitation
- FINRA Investor Education Foundation – Aging and Financial Decision Making Research Studies
- FINRA Investor Education Foundation – Exposed to Scams, What Separates Victims from Non-Victims

Joint SEC, FINRA and NASAA Materials

- Training for the Securities Industry: Addressing and Reporting Financial Exploitation of Senior and Vulnerable Adult Investors
- Trusted Contact Video
- Trusted Contact Fact Sheet

Resources

- **Self-Reported Reasons for Customers Engaging with a Scam:**
  - “They seemed official.”
  - “I was under time pressure.”
  - “I thought the person was nice.”
  - “I worried about missing out on an opportunity.”
  - “They seemed to know personal details about me.”
  - '“I felt intimidated.”
  - “I had an opportunity to get ahead financially.”
  - “I deserved to be rewarded.”
  - “I had an opportunity to make good on past mistakes.”
  - “I wanted to please the person I was dealing with.”
  - “I felt afraid of being punished.”

Source:
FINRA Investor Education Foundation – Exposed to Scams, What Separates Victims from Non-Victims

Resources

Non-FINRA Resources

- AARP Fraud Watch Network Helpline (877-908-3360)
- AARP BankSafe Initiative and Training Platform
- US Department of Justice National Elder Fraud Hotline (833-372-8311)

State Reporting Resources

- National Center on Elder Abuse: State Resources and Reporting Directory
- HelpVul Unified Reporting Portal
- 50 State Survey of Senior and Vulnerable Adult Investor Laws

Senior and At-Risk Investors
Monday, May 16, 2022
11:15 a.m. – 12:15 p.m.

Resources:

FINRA Resources:

- FINRA Securities Helpline for Seniors

  www.finra.org/investors/have-problem/helpline-seniors

- Protecting Senior Investors 2015-2020 Report

  www.finra.org/rules-guidance/key-topics/senior-investors/protecting-senior-investors-2015-2020

- FINRA *Regulatory Notice 22-05, FINRA Adopts Amendments to FINRA Rule 2165* (February 2022)

  www.finra.org/rules-guidance/notices/22-05

- FINRA *Regulatory Notice 20-38, FINRA Adopts Rule to Limit a Registered Person From Being Named a Customer's Beneficiary or Holding a Position of Trust for or on Behalf of a Customer* (October 2020)

  www.finra.org/rules-guidance/notices/20-38

- FINRA *Regulatory Notice 20-34, Proposed Amendments to FINRA Rule 2165 and Retrospective Rule Review Report* (October 2020)

  www.finra.org/rules-guidance/notices/20-34

- FINRA Virtual Panel: Communication Between APS and Professional Reporters of Financial Exploitation

  www.finra.org/events-training/virtual-conference-panels/communication-between-adult-protective-services-aps-and-professional

- FINRA Podcast: Anti-Money Laundering and Elder Exploitation

  www.finra.org/media-center/finra-unscripted/aml-elder-financial-exploitation

- FINRA Investor Education Foundation - Aging and Financial Decision Making Research Studies

  www.finrafoundation.org/knowledge-we-gain-share/aging-and-financial-decision-making

- FINRA Investor Education Foundation - Exposed to Scams, What Separates Victims from Non-Victims

  www.finrafoundation.org/sites/finrafoundation/files/exposed-to-scams-what-separates-victims-from-non-victims_0_0.pdf

Joint SEC, FINRA and NASAA Resources:

- Training for the Securities Industry: Addressing and Reporting Financial Exploitation of Senior and Vulnerable Adult Investors

  www.finra.org/rules-guidance/key-topics/senior-investors/elder-abuse-prevention-training

- Establishing a Trusted Contact Video

  www.finra.org/investors/learn-to-invest/brokerage-accounts/establish-trusted-contact

- Trusted Contact Fact Sheet

  www.finra.org/sites/default/files/2021-09/trusted-contact-infographic.pdf

Non-FINRA Resources:

- AARP Fraud Watch Network Helpline (877-908-3360)

  www.aarp.org/money/scams-fraud/helpline.html

- The AARP Bank*Safe* Initiative

  www.aarp.org/ppi/banksafe/

- The AARP Bank*Safe* Training

  https://interest.banksafetraining.aarp.org/?intcmp=PPI-BNKSF-TERTNAV-SIGNUP

- US Department of Justice National Elder Fraud Hotline (833-372-8311)

  www.ovc.ojp.gov/program/stop-elder-fraud/providing-help-restoring-hope

State Reporting Resources:

- National Center on Elder Abuse: State Resources and Reporting Directory

  www.ncea.acl.gov/Resources/State.aspx

- HelpVul Unified Reporting Portal

  www.eversafe.com/helpvul/

- Bressler's 50 State Survey of Senior and Vulnerable Adult Investor Laws

  www.bressler.com/senior-map

Advanced Analytics: Transforming the Industry With People, Processes & Technology

Monday, May 16, 2022
11:15 a.m. – 12:15 p.m.

Whether you're new to the topic or an expert in machine learning, gain practical knowledge to leverage expertise, reimagine problems, deploy capabilities, and capture business value using advanced analytics while controlling for risks and addressing regulatory concerns. During the session panelists discuss successes, challenges, and best practices in implementing advanced analytics.

Moderator:

Brad Ahrens
Senior Vice President, Advanced Analytics
FINRA Office of the Chief Executive Officer

Panelists:

Terrence Bohan
Vice President, Enforcement Investigations
FINRA Enforcement

Eren Kurshan
Head of Research and Methodology LCD
Morgan Stanley

Kalyan Sengupta
Managing Director and Head of Digitalization of Compliance, Conduct & Operational Risk (CCOR)
J.P. Morgan

Advanced Analytics: Transforming the Industry With People, Processes & Technology Panelists Bios:

Moderator:

Brad Ahrens, Senior Vice President of Advanced Analytics, oversees FINRA's analytics strategy and implementations—including machine learning, artificial intelligence and data visualization—to further enable investor protection and safeguard the financial markets. He also chairs FINRA's Advanced Analytics Leadership Team, which is charged with identifying and deploying analytics opportunities that will maximize the benefits to investors, member firms, and FINRA. Before joining FINRA in September 2021, Mr. Ahrens spent more than 20 years at Charles Schwab. Most recently, he served as Vice President of Risk Technology, Analytics and Change for the firm's Enterprise Risk Management department. In that role, Mr. Ahrens oversaw the development, testing and implementation of applications used across Charles Schwab's risk management and compliance programs. He also led the Risk Analytics Team providing data engineering and business intelligence to risk partners. Before assuming that role, he worked in various other compliance positions at the firm with a focus on surveillance, sales practice, operations, digital, financial crimes, and building collaborative partnerships to bridge the gap between regulation and technology. Mr. Ahrens holds a BA in International Relations from the University of Wisconsin-Madison.

Panelists:

Terrence Bohan is Vice President of Investigations for FINRA's Department of Enforcement. In this capacity, Mr. Bohan manages Enforcement investigators throughout the country as they investigate potential securities violations and, when warranted, bring formal disciplinary actions against firms and their associated persons. Mr. Bohan also oversees Enforcement's Data Analytics team and the Forensic Investigations and Litigation Support group, which supports FINRA's use of forensic tools and e-discovery technologies. Before he joined FINRA in 2018, Mr. Bohan spent more than 23 years with the SEC's New York Regional Office's broker-dealer inspection program, primarily as a cause examination manager. In that role, Mr. Bohan identified and developed cases involving fraudulent securities offerings, manipulations, Ponzi schemes, unregistered securities distributions, money laundering, and egregious sales practice schemes. He has worked extensively with law enforcement in the New York area, including the U.S. Attorney's Office, Federal Bureau of Investigation, Internal Revenue Service, Postal Inspection Service, and Manhattan District Attorney's Office. Mr. Bohan received his Bachelor of Science degree in finance from Fordham University.

Eren Kurshan is Head of Research and Methodology leading the research and development efforts in strategic emerging technology areas at Morgan Stanley. Prior to this role, she was the Head of AI and Machine Learning for Client Protection at Bank of America, where she led AI/machine learning-based solution development for fraud and financial crime detection. Dr. Kurshan and her team built the first generation of in-house AIML models covering Bank of America's payment systems portfolio (2nd largest in the US with $3.8 trillion USD in total payments in 2021) and online banking platforms. Before Bank of America, Dr. Kurshan led a number of AI and data science programs at Columbia University, J.P. Morgan Investment Bank, and IBM focusing on financial crime detection, cybersecurity and investment banking applications. Dr. Kurshan received her Ph.D. in Computer Science from the University of California. She has been serving as an Executive-in-Residence at Princeton University since 2021.

Kalyan Sengupta is Managing Director and Head of Digitalization of Compliance, Conduct & Operational Risk (CCOR) at JPMorgan Chase & Co. In his current role, he is responsible to digitize and transform the firm's Compliance, Conduct and Risk teams in driving an increasingly data-driven focus into the everyday decision-making and process execution of CCOR's risk management practices. Prior to his current role, Mr. Sengupta was Managing Director of Data, Analytics, Machine Learning and Reporting for Global Banking at Bank of America. In this role, he was responsible for

digital transformation and building a data-driven organization in support of their Wholesale Credit Transformation effort as well as streamlining and supporting Payments, Services and Fulfillment Value Chain as part of their Global Treasury Services Digital Transformation. Prior to his role at Bank of America, Mr. Sengupta spent time at Merrill Lynch, Wachovia, PNC and Mellon Bank where he held several roles both building Asset management and trading and risk systems and trade-related repositories. Mr. Sengupta received a bachelor's degree in Mechanical Engineering from the National Institute of Technology, India, and a master's degree in Computer Science from Birla Institute of Technology and Science, India. Additionally, he obtained Management & Leadership certification from The George Washington University School of Business and completed Executive education from The Scheller College of Business, Georgia Tech.

Advanced Analytics: Transforming the Industry With People, Processes & Technology

Panelists

- **Moderator**
  - Brad Ahrens, Senior Vice President, Advanced Analytics, FINRA Office of the Chief Executive Officer
- **Panelists**
  - Terrence Bohan, Vice President, Enforcement Investigations, FINRA Enforcement
  - Eren Kurshan, Head of Research and Methodology LCD, Morgan Stanley
  - Kalyan Sengupta, Managing Director and Head of Digitalization of Compliance, Conduct & Operational Risk (CCOR), J.P. Morgan

Advanced Analytics: Transforming the Industry With People, Processes & Technology
Monday, May 16, 2022
11:15 a.m. – 12:15 p.m.

Resources:

- FINRA Artificial Intelligence in the Securities Industry Page

  www.finra.org/rules-guidance/key-topics/fintech/report/artificial-intelligence-in-the-securities-industry

- "Getting Your Analytics Team Right!" Five necessary roles for a successful analytics team. *Towards Data Science* (April 1, 2020)

  www.towardsdatascience.com/getting-your-analytics-team-right-b539206dac3d

- Brown, Sara. "How to build a data analytics dream team", *MIT Management Sloan School* (May 27, 2020)

  www.mitsloan.mit.edu/ideas-made-to-matter/how-to-build-a-data-analytics-dream-team

- Stackpole, Beth. "Decisions, Not Data, Should Drive Your Analytics Program", *MIT Management Sloan School* (June 29, 2021)

  www.mitsloan.mit.edu/ideas-made-to-matter/decisions-not-data-should-drive-analytics-programs

- "Building an Analytics Team from the Ground Up", *Villanova University* Blog.

  www.taxandbusinessonline.villanova.edu/blog/building-an-analytics-team-from-the-ground-up/

- Miller, Kelsey. "Data-Driven Decision Making: A Primer for Beginners", *Northeastern University* (August 22, 2019)

  www.northeastern.edu/graduate/blog/data-driven-decision-making/

- Artificial Intelligence/Machine Learning Risk & Security Working Group (AIRS), "Artificial Intelligence Risk & Governance", *Wharton University of Pennsylvania*

  www.ai.wharton.upenn.edu/artificial-intelligence-risk-governance/

- Kozyrkov, Cassie. "AI for all humans: A course to delight and inspire!" Blog, *Google Cloud* (December 6, 2021)

  www.cloud.google.com/blog/topics/developers-practitioners/ai-all-humans-course-delight-and-inspire

- Redman, Thomas. "Your Data Initiatives Can't Just Be for Data Scientists", *Harvard Business Review* (March 22, 2022)

  www.hbr.org/2022/03/your-data-initiatives-cant-just-be-for-data-scientists

- Harvard Business Review: Embracing Data Analytics for More Strategic Value Pulse Survey (2021)

  www.hbr.org/resources/pdfs/comm/sisense2/EmbracingDataAnalytics.pdf

- IOSCO The Use of Artificial Intelligence and Machine Learning by Market Intermediaries and Asset Managers Consultation Report (2020)

  www.iosco.org/library/pubdocs/pdf/IOSCOPD658.pdf

- Thomson Reuters Demystifying Artificial Intelligence (AI): A Legal Professional's Guide Through the Noise

  www.legal.thomsonreuters.com/en/insights/white-papers/demystifying-ai

Advanced Analytics: Transforming the Industry with People, Processes, and Technology

FINRA Annual Conference

May 2022

Helpful Reading & Videos

PEOPLE

- Getting Your Analytics Team Right
  https://towardsdatascience.com/getting-your-analytics-team-right-b539206dac3d
- How to Build an Analytics Dream Team
  https://mitsloan.mit.edu/ideas-made-to-matter/how-to-build-a-data-analytics-dream-team
- Building an Analytics Team from the Ground Up https://taxandbusinessonline.villanova.edu/blog/building-an-analytics-team-from-the-ground-up/

PROCESSES & DECISION MAKING

- Decisions, Not Data, Should Drive Your Analytics Program https://mitsloan.mit.edu/ideas-made-to-matter/decisions-not-data-should-drive-analytics-programs
- Data Driven Decision Making: A Primer
  https://www.northeastern.edu/graduate/blog/data-driven-decision-making/
- Embracing Analytics for Strategic Value
  https://hbr.org/resources/pdfs/comm/sisense2/EmbracingDataAnalytics.pdf
- Your Data Initiatives Can't Be Just for Data Scientists https://hbr.org/2022/03/your-data-initiatives-cant-just-be-for-data-scientists

Helpful Reading & Videos

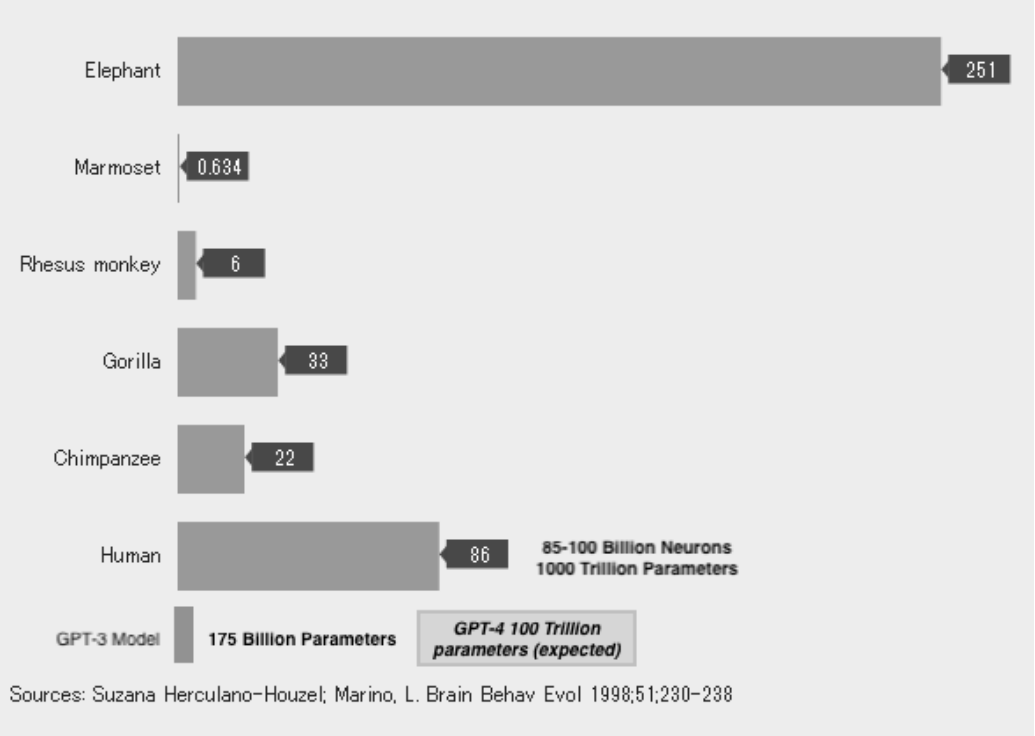
MANAGING & SUPERVISING THE RISKS

- Artificial Intelligence in the Securities Industry https://www.finra.org/rules-guidance/key-topics/fintech/report/artificial-intelligence-in-the-securities-industry
- The Use of AI & Machine Learning by Market Intermediaries & Asset Managers https://www.iosco.org/library/pubdocs/pdf/IOSCOPD658.pdf
- Artificial Intelligence Risk & Governance https://ai.wharton.upenn.edu/artificial-intelligence-risk-governance/

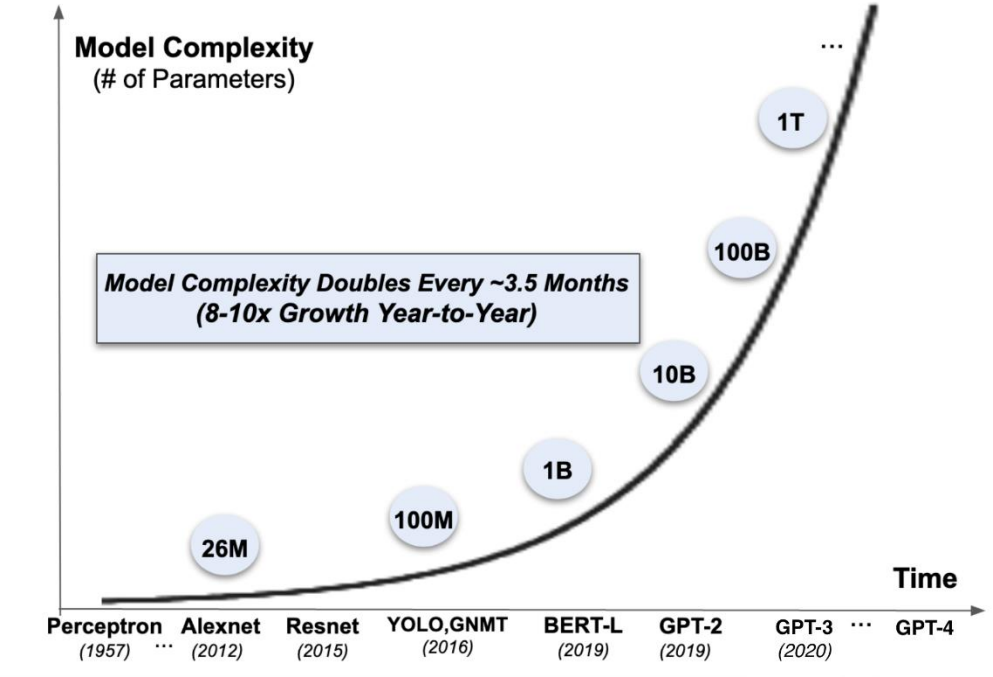
AI & MACHINE LEARNING

- Making Friends with Machine Learning https://cloud.google.com/blog/topics/developers-practitioners/ai-all-humans-course-delight-and-inspire
- Demystifying AI: A Legal Professional's Guide Through the Noise https://legal.thomsonreuters.com/en/insights/white-papers/demystifying-ai

1. Neuron Count



2. Model Complexity



3. Self-Regulating Models

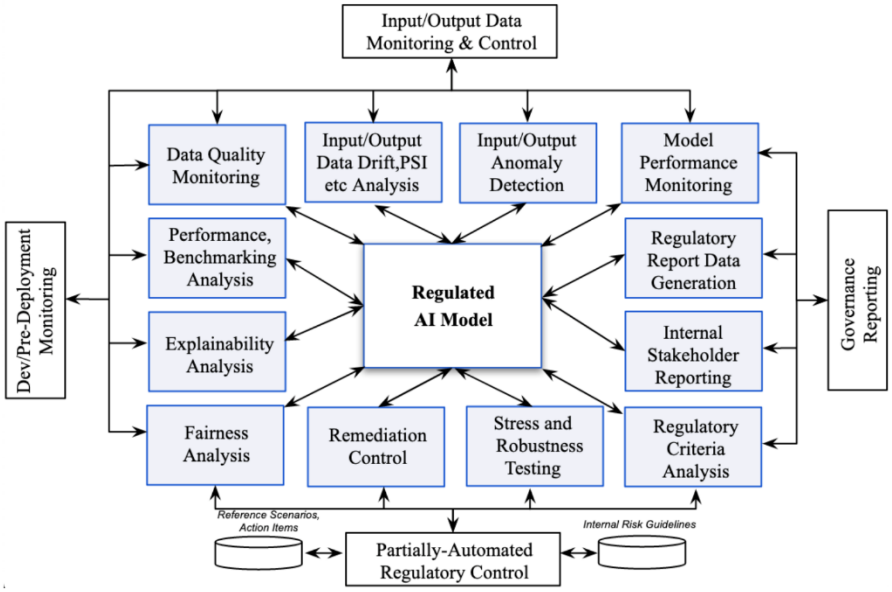


Figure 7: High-level view of the AI system framework with self-regulatory capabilities.

4. Model Governance

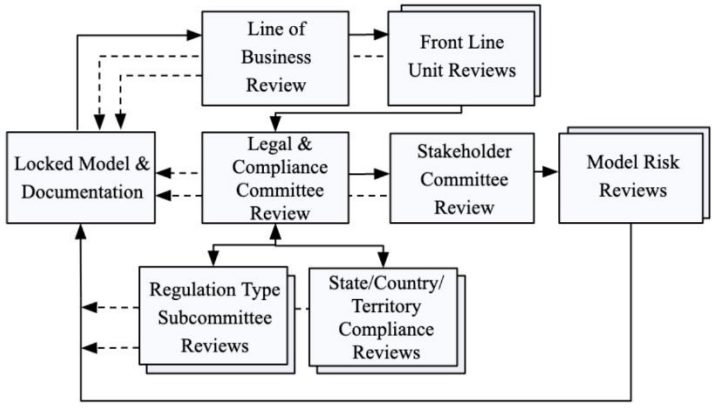
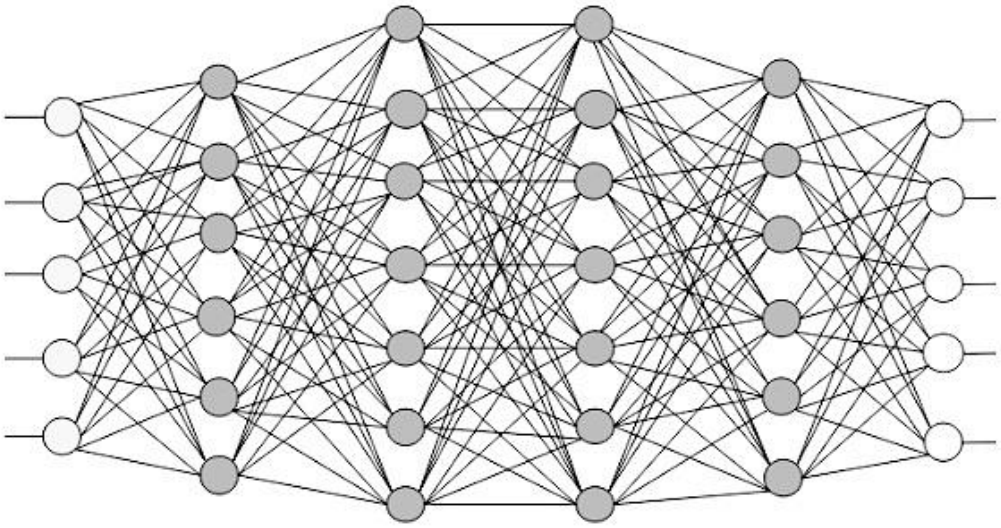
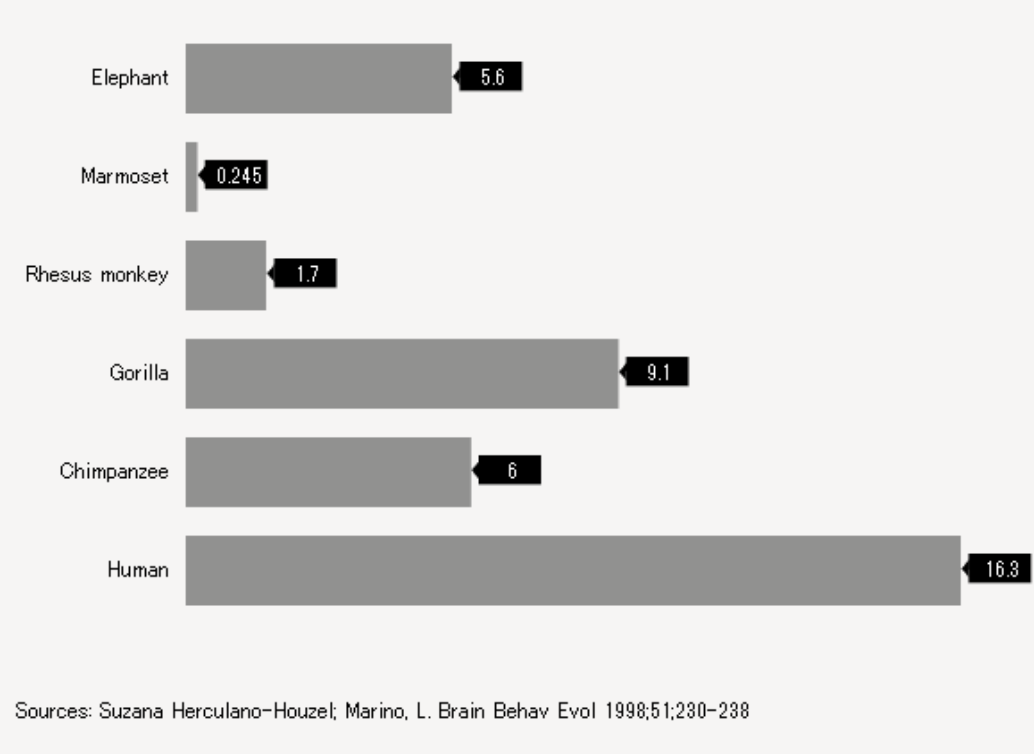


Figure 4: A sample partial view of AI model governance committee reviews.

5. Neural Network



Backup



Environmental, Social and Governance (ESG) Developments
Monday, May 16, 2022
1:45 p.m. – 2:45 p.m.

Join FINRA staff and industry practitioners as they discuss ESG developments. This session includes a discussion on current regulatory expectations and ways to effectively implement and manage ESG investing at your firm.

Moderator:

Nathaniel Stankard
Senior Vice President and Senior Advisor
FINRA Office of the Chief Executive Officer

Panelists:

Brian Callery, CFP®, AAMS®
Financial Advisor
Edward Jones

Yves Denize
Senior Managing Director and Division General Counsel
Nuveen

Mark Kim
Chief Executive Officer
Municipal Securities Rulemaking Board (MSRB)

Matthew Slovik
Managing Director and Head of Global Sustainable Finance
Morgan Stanley

Environmental, Social and Governance (ESG) Developments Panelists Bios:

Moderator:

Nathaniel Stankard is Senior Vice President and Senior Advisor to the CEO. Mr. Stankard joined FINRA in 2017. Prior to joining FINRA, he worked for the U.S. Securities and Exchange Commission for seven years. He first served as the Counsel to the Director of the Division of Trading and Markets and later as the Deputy Chief of Staff for Policy in the Office of Chair Mary Jo White, where he managed the rulemaking agenda of the Commission; advised the Chair on a diverse range of complex legal and policy matters; coordinated cross-agency staff teams comprised of policy, legal and economic experts; and represented the Chair in negotiations with other agencies and market participants. His financial industry background also includes Morgan Stanley, where he was an Executive Director in what is now the Global Sustainable Finance Group, and Cleary Gottlieb Steen & Hamilton LLP, where he was an associate responsible for complex securities law matters. Mr. Stankard received a Bachelor of Arts Degree in Economics from Oberlin College and received his J.D. from Harvard Law School.

Panelists:

Brian Callery, CFP®, AAMS® is Partner and Regional Leader for Edwards Jones. For almost 20 years, Edward Jones General Partner Mr. Callery has served investors as a financial advisor. Specializing in preparing for and living in retirement, as well as wealth transfer strategies for leaving a legacy, Mr. Callery is a frequent speaker on retirement transition readiness for both federal agencies and international organizations. In addition to serving clients, Mr. Callery has served as a Regional Leader for the past five years. As a Regional Leader, Mr. Callery is responsible for the guidance and support to a network of approximately 65 branch teams in the Washington D.C. metropolitan area. Mr. Callery began his career with Edward Jones in the firm's St. Louis headquarters, where he worked in a variety of areas within the firm. After building his own business, he turned his attention to helping other financial advisors enhance and expand their client relationships by serving in a variety of leadership roles. Mr. Callery also helped develop the firm's Culture of Compliance Leader (CCL) role, which is a field-based role, held by a financial advisor. As a part of regional leadership teams, CCLs lead the development and implementation of strategies, connected to the firm's purpose, that effectively preserve and strengthen the firm's culture of compliance and core values within their regions. Mr. Callery holds a bachelor's degree in business administration-finance from the University of Richmond and CFP® and AAMS® professional designations.

Yves Denizé is Senior Managing Director & Division General Counsel for Nuveen's Legal group. He supports provision of investment and asset management product related legal services for the asset management business, providing guidance and direction to clients and staff. He is a member of the Nuveen Legal management team reporting to Nuveen's Chief Legal Officer. Nuveen is the asset management business of Teachers Insurance and Annuity Association of America (TIAA). Prior to his current role, Mr. Denizé served as Managing Director & General Counsel, Broker-Dealer & Investments, leading legal support for Broker-Dealer issues and of the Fixed Income and Alternative Investment program. Earlier in his career with TIAA, he provided advice and support to TIAA's Asset Management Area in connection with domestic and international private placements of debt and equity securities, including private equity funds, alternative investments, and derivatives. He has supported product development initiatives, including fund formation. He has also supported strategic sale and acquisition initiatives. Prior to joining TIAA, Mr. Denizé served as Counsel to the NYS Comptroller's Deputy Comptroller for New York City. He also was an Associate at Cleary, Gottlieb, Steen & Hamilton. Mr. Denizé graduated from Dartmouth College and received his J.D. degree, *cum laude*, from New York University School of Law. He has served as a member of the American College of Investment Counsel and on the New York City Bar Committee on Private Investment Funds.

Mark T. Kim is Chief Executive Officer of the Municipal Securities Rulemaking Board (MSRB). Prior to his current role, Mr. Kim served as Chief Operating Officer from 2017-2020. He served on the MSRB's Board of Directors from 2015-2017, where he was a member of the Finance and Steering Committees and chaired the Audit Committee. Before joining the MSRB, Mr. Kim was chief financial officer for the District of Columbia Water and Sewer Authority (DC Water). In this role, he was responsible for establishing DC Water's award-winning green bond program, which included the first third-party certified green bond issued in the United States and the first 100-year green bond issued globally. He also issued the first environmental impact bond with a novel structure that linked the interest payment on the bond to the attainment of targeted environmental outcomes. This groundbreaking transaction has since been replicated in several cities across the country. Previously, he served as the Deputy Comptroller for the City of New York and worked as an investment banker at Goldman Sachs, UBS, and Fidelity Capital Markets. Mr. Kim received a Ph.D. in public policy from Harvard University, a law degree from Cornell Law School and a bachelor's degree from Northwestern University. He is a member of the bars of New York State and the District of Columbia.

Matthew Slovik is Managing Director and Head of Morgan Stanley's Global Sustainable Finance group, where he leads the firmwide sustainable finance strategy and focuses on mobilizing private-sector capital to address major global challenges. Mr. Slovik works across the firm to develop client-focused financial products and solutions that integrate sustainability and target strong financial returns as well as positive environmental or social impact. Under Mr. Slovik's leadership, Morgan Stanley continues to develop innovative sustainable and impact investing solutions for institutions and individuals. Mr. Slovik has spent his entire career at Morgan Stanley, where he began working as an analyst in the firm's Investment Banking Division. Most recently, he worked in Morgan Stanley Alternative Investment Partners (AIP), the firm's institutional private equity fund investing business, where he helped lead the build out of the private equity impact investing program. During his career at Morgan Stanley, Mr. Slovik has also worked in the firm's Global Capital Markets, Wealth Management and Firm Management divisions. He received a B.A. in Public Policy from Duke University.

Environmental, Social and Governance (ESG) Developments

Panelists

- **Moderator**
  - Nathaniel Stankard, Senior Vice President and Senior Advisor, FINRA Office of the Chief Executive Officer
- **Panelists**
  - Brian Callery, CFP®, AAMS®, Financial Advisor, Edward Jones
  - Yves Denize, Senior Managing Director and Division General Counsel, Nuveen
  - Mark Kim, Chief Executive Officer, Municipal Securities Rulemaking Board (MSRB)
  - Matthew Slovik, Managing Director and Head of Global Sustainable Finance, Morgan Stanley

Environmental, Social and Governance (ESG) Developments
Monday, May 16, 2022
1:45 p.m. – 2:45 p.m.

Resources:

- FINRA Key Topics for World Investor Week 2021: Investor Bulletin

  www.finra.org/investors/insights/key-topics-world-investor-week-2021

- FINRA ESG Investing—Clearing the Air on Social Impact Financial Products

  www.finra.org/investors/insights/esg-investing-clearing-air-social-impact-financial-products

- FINRA Investor Education Foundation, *Investors Say They Can Change The World, If They Only Knew How: Six Things to Know About ESG and Retail Investors* (March 2022)

  www.finrafoundation.org/sites/finrafoundation/files/Consumer-Insights-Money-and-Investing.pdf

- SEC Response to Climate and ESG Risks and Opportunities

  www.sec.gov/sec-response-climate-and-esg-risks-and-opportunities

- SEC Press Release, *SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors* (March 2022)

  www.sec.gov/news/press-release/2022-46

- SEC Risk Alert, *The Division of Examinations' Review of ESG Investing* (April 2021)

  www.sec.gov/files/esg-risk-alert.pdf

FINRA's Examination and Risk Monitoring Program
Monday, May 16, 2022
1:45 p.m. – 2:45 p.m.

Join FINRA staff as they discuss FINRA's examination and risk monitoring programs. During the session, panelists review various examination and risk monitoring trends and current rulemaking initiatives.

Moderator:

Ornella Bergeron
Senior Vice President, Head of Member Supervision Risk Monitoring
FINRA Member Supervision

Panelists:

Paxton Dunn
Director, Risk Monitoring Standards
FINRA Member Supervision

Andrew McElduff
Senior Director, Retail Risk Monitoring
FINRA Member Supervision

Joseph Sheirer
Vice President, Head of Firm Examination Program
FINRA Member Supervision

FINRA's Examination and Risk Monitoring Program Panelists Bios:

Moderator:

Ornella Bergeron is Senior Vice President and Firm Group Leader for FINRA member firms assigned to the Diversified, Carrying and Clearing, Retail, and Capital Markets firm groupings. In this capacity, she has responsibility for the Single Points of Accountability and Risk Monitoring Program teams for these firms, which includes the assessment of financial, operational, business conduct, and trading risks. She and her team are also responsible for coordinating with Examination Program Management on the strategy and execution of related examinations. Prior to this role, Ms. Bergeron was a Unit Leader in the Risk Oversight and Operational Regulation group of Member Supervision responsible for the Risk Monitoring and Financial and Operational examinations of approximately 200 of FINRA's largest member firms. She has been with FINRA since its inception in 2007. Prior to joining FINRA, she spent 19 years in the Division of Member Firm Regulation at the New York Stock Exchange in Risk Monitoring management and examination roles. Ms. Bergeron holds a BBA in Finance from Iona College.

Panelists:

Paxton Dunn, Director, 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.

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, Andrew oversees three Risk Monitoring teams responsible for monitoring and assessing risk across the Retail - Private Placement and Retail – Pooled Investment & Variable Annuity firms. Andrew 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, Andrew 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. Andrew joined FINRA in September 2007 after working at a startup handling day to day operations and managing a national sales team. Andrew is a graduate of the University of North Carolina at Chapel Hill.

Joseph J. Sheirer currently oversees FINRA's Member Supervision Firm Examination program. Previously, Mr. Sheirer was the Regional Director of FINRA's North Region with offices in Boston, Philadelphia and Woodbridge; developed and oversaw FINRA's national Membership Application Program group; and worked in varying capacities in a number of other FINRA departments including Risk Oversight & Operational Regulation, Continuing Education, Testing, and Qualifications & Registration. Mr. Sheirer is a graduate of Brooklyn Law School and Drew University and is a member of the Bars of the States of New York and New Jersey.

FINRA's Examination and Risk Monitoring Program

Panelists

- **Moderator**
  - Ornella Bergeron, Senior Vice President, Head of Member Supervision Risk Monitoring, FINRA Member Supervision
- **Panelists**
  - Paxton Dunn, Director, Risk Monitoring Standards, FINRA Member Supervision
  - Andrew McElduff, Senior Director, Retail Risk Monitoring, FINRA Member Supervision
  - Joseph Sheirer, Vice President, Head of Firm Examination Program, FINRA Member Supervision

FINRA's Examination and Risk Monitoring Program
Monday, May 16, 2022
1:45 p.m. – 2:45 p.m.

Resources:

- FINRA Unscripted Podcast - Single Points of Accountability: Navigating Firms' Experiences with FINRA

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

- FINRA Unscripted Podcast - Report on FINRA's Examination and Risk Monitoring Program | A Comprehensive Reference Item for Firms

  www.finra.org/media-center/finra-unscripted/2022-report-examination-and-risk-monitoring-program

- 2022 Report on FINRA's Examination and Risk Monitoring Program (February 2022)

  www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program

Market Regulation and Transparency Services Priorities
Monday, May 16, 2022
1:45 p.m. – 2:45 p.m.

This session provides updates on market regulation and transparency priorities, including current initiatives and rulemaking. FINRA panelists share thoughts on equities, options, and fixed income compliance programs.

Moderator:
Susan Tibbs
Senior Vice President, Market Manipulation
FINRA Market Regulation

Panelists:
Gene DeMaio
Executive Vice President, Options Regulation and T&E
FINRA Market Regulation

Jon Kroeper
Executive Vice President, Quality of Markets
FINRA Market Regulation

Ola Persson
Senior Vice President, Head of Transparency Services
FINRA Market Regulation

Market Regulation and Transparency Services Priorities Panelists Bios:

Moderator:

Susan Tibbs is Vice President of the Market Manipulation Group in the Quality of Markets section in FINRA's Department of Market Regulation. She has developed a specialty in complex products, new exchanges, and cross market surveillance and investigations. She oversees FINRA's Cross Market Manipulation Surveillance Patterns and directs investigations for equity products both traded on and off exchange. Over the years she has been instrumental in the planning and implementation of surveillance patterns for various FINRA clients. Currently, she is part of the leadership team managing the implementation of deep learning in production surveillance patterns for Market Regulation. Ms. Tibbs holds a B.A. in International Affairs from the George Washington University and a Juris Doctorate from Western Michigan University Thomas M. Cooley Law School. She loves to learn new things and has dedicated her career to investor protection.

Panelists:

Gene DeMaio is Executive Vice President in FINRA's Market Regulation Department where he manages the Options Regulation section and the Trading & Execution examination firm grouping. Prior to joining FINRA, Mr. DeMaio was an Options Market Maker at the American Stock Exchange, and earlier worked as an attorney at the law firm of Kord Lagemann where he represented complainants in securities arbitration disputes. Mr. DeMaio is a graduate of Fordham Law and earned his LL.M at New York University.

Jon Kroeper is Executive Vice President of the Quality of Markets Section of FINRA's Market Regulation Department. The Quality of Markets Section is responsible for the conduct of post-trade surveillance and investigations related to data integrity, market conduct and customer protection rules, and market manipulation activity in the U.S. equity and fixed income markets regulated by FINRA as a self-regulatory organization and as a provider of regulatory services to other U.S. SROs. Prior to joining FINRA's predecessor NASD in early 2007, Mr. Kroeper served as Counsel to U.S. Securities and Exchange Commission Chairman Chris Cox in 2006 and 2007, and Counsel to Commissioner Paul S. Atkins in 2005. From 2000 to 2005, Mr. Kroeper was First Vice President and Associate General Counsel for Instinet Group Incorporated. Mr. Kroeper began his career at the U.S. Securities and Exchange Commission in 1994, serving as a senior counsel in the Division of Market Regulation and subsequently as Counsel to Commissioner Laura S. Unger. Mr. Kroeper received a bachelor's degree from Georgetown University and a law degree, *cum laude*, from Chicago-Kent College of Law.

Ola Persson is Senior Vice President and head of FINRA's Transparency Services Department. He is responsible for all business, technology and operational aspects related to FINRA's fixed income and equity trade reporting and quotation facilities (TRACE, ADF, ORF, OTCBB and the TRF's). Mr. Persson joined FINRA in 2004, with responsibilities for the fixed income (TRACE) program. Prior to joining FINRA, Mr. Persson worked for 10 years at Thomson Reuters where he held a number of positions in the Fixed Income division. He holds a Bachelor's degree in Finance and Statistics from the University of Stockholm, Sweden, and a Master's degree in International Business from Baruch, City University of New York.

Market Regulation and Transparency Services Priorities

Panelists

- **Moderator**
  - Susan Tibbs, Senior Vice President, Market Manipulation, FINRA Market Regulation
- **Panelists**
  - Gene DeMaio, Executive Vice President, Options Regulation and T&E, FINRA Market Regulation
  - Jon Kroeper, Executive Vice President, Quality of Markets, FINRA Market Regulation
  - Ola Persson, Senior Vice President, Head of Transparency Services, FINRA Market Regulation

To Access Polling

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

  - Select your polling answers.

Polling Question 1

1. **What interactions with Market Regulation and Transparency Services do firms find most helpful?**
   a. Report Cards
   b. Regular one-on-one meetings
   c. Conference calls with a large group of firms

Polling address: **https://finra.cnf.io/sessions/ywzq**

FEBRUARY 2022

2022 Report on FINRA's Examination and Risk Monitoring Program

Introduction

The 2022 Report on FINRA's Examination and Risk Monitoring Program (the Report) provides firms with information that may help inform their compliance programs. For each topical area covered, the Report identifies the relevant rule(s), highlights key considerations for member firms' compliance programs[1], summarizes noteworthy findings from recent examinations, outlines effective practices that FINRA observed during its oversight, and provides additional resources that may be helpful to member firms in reviewing their supervisory procedures and controls and fulfilling their compliance obligations.

FINRA's intent is that the Report be an up-to-date, evolving resource or library of information for firms. To that end, the Report builds on the structure and content in the 2021 Report by adding new topics (*e.g.,* Disclosure of Order Routing Information, Funding Portals) denoted **NEW FOR 2022** and new material (*e.g.,* new exam findings, effective practices) to existing sections where appropriate. (New material in existing sections is in **bold** type.) In addition, those general findings that are also particularly relevant for firms in their first year of operation are denoted with a star (★).

As always, FINRA welcomes feedback on how we can improve future publications of this Report. Please contact Steve Polansky, Senior Director, Member Supervision at (202) 728-8331 or by email; or Rory Hatfield, Associate Principal Research Analyst, Member Supervision at (240) 386-5487 or by email.

Selected Highlights

In 2021, considerable industry, and in some cases public, attention was focused on topics that FINRA also addressed through its exam and risk monitoring program. These topics include newer SEC Rules (*e.g.,* Regulation Best Interest (Reg BI), Form CRS, amendments to Rule 606), recent increases in the number and sophistication of cybersecurity threats, and the proliferation of securities trading through mobile apps.

Reg BI and Form CRS

During Reg BI's and Form CRS' first full calendar year of implementation in 2021, FINRA expanded the scope of its reviews and testing relative to 2020 to execute a more comprehensive review of firms' processes, practices and conduct in areas such as establishing and enforcing adequate written supervisory procedures (WSPs); filing, delivering and tracking accurate Forms CRS; making

recommendations that adhere with Reg BI's Care Obligation; identifying and mitigating conflicts of interest; and providing effective training to staff. In this Report, FINRA notes its initial findings from its Reg BI and Form CRS reviews during the past year and will share additional findings at a future date.

CAT

FINRA continues to evaluate member firms that receive or originate orders in National Market System (NMS) stocks, over-the-counter (OTC) equity securities and listed options for compliance with Securities Exchange Act of 1934 (Exchange Act) Rule 613 and the CAT NMS Plan FINRA Rule 6800 Series (Consolidated Audit Trail Compliance Rule) (collectively, CAT Rules). This year's Report addresses compliance with certain CAT obligations, such as reporting CAT information to the Central Repository and maintaining an effective supervision process (including clock synchronization performed by third-party vendors).

Order Handling, Best Execution and Conflicts of Interest

Assessing firms' compliance with their best execution obligations under FINRA Rule 5310 (Best Execution and Interpositioning) is one of the cornerstones of FINRA's oversight activities. This oversight has evolved with changes in firms' business models, for example the advent of the "zero commission" model.

As noted in last year's Report, FINRA launched a targeted exam to "evaluate the impact that not charging commissions has or will have on the member firms' order-routing practices and decisions, and other aspects of member firms' business." FINRA will share its findings with member firms at a future date.

In addition, FINRA is focusing on firms' compliance with Rule 606 of Regulation NMS, which requires broker-dealers to disclose information regarding the handling of their customers' orders in NMS stocks and listed options. This information provides transparency to customers and can help them: better understand how their firm routes and handles their orders; assess the quality of order handling services provided by their firm; and determine whether their firm is effectively managing potential conflicts of interest that may impact their firm's routing decisions.

Mobile Apps

Advances in technology and its application continue to reshape the way some firms attract and interact with customers on mobile apps. These innovations can benefit investors in several ways, including increasing their market participation, expanding the types of products available to them and educating them on financial concepts. At the same time, however, these apps raise novel questions and potential concerns, such as whether they encourage retail investors to engage in trading activities and strategies that may not be consistent with their investment goals or risk tolerance, and how the apps' interface designs could influence investor behavior.

FINRA has identified significant problems with some mobile apps' communications with customers and firms' supervision of activity on those apps (particularly controls around account openings). FINRA has also observed mobile apps making use of social media to acquire customers, and recently initiated a targeted exam to assess firms' practices in this area, including with respect to firms' management of their obligations related to information collected from those customers and other individuals who may provide data to firms; FINRA will share its findings from this review after its completion.

Special Purpose Acquisition Companies (SPACs)

Another topic that has received significant attention is the increased use of Special Purpose Acquisition Companies (SPACs) to bring companies public. For example, in 2019, approximately 25 percent of initial public offerings were accomplished through SPACs; in the first quarter of 2021, this figure was over 70 percent.

FINRA recognizes how SPACs can provide companies with access to diverse funding mechanisms and allow investors to access new investment opportunities; however, as SPAC activity has increased, so too has FINRA's focus on broker-dealers' compliance with their regulatory obligations in executing SPAC transactions. In October 2021, FINRA launched a targeted exam to explore a range of issues, including how firms manage potential conflicts of interest in SPACs, whether firms are performing adequate due diligence on merger targets and if firms are providing adequate disclosures to customers. At a future date, FINRA will share with member firms its findings from this review.

Cybersecurity

Cybersecurity threats are one of the primary risks firms and their customers face. Over the past year, FINRA has continued to observe increases in the number and sophistication of these threats. For example, in 2021, FINRA has alerted firms about phishing campaigns involving fraudulent emails purporting to be from FINRA, as well as new customers opening online brokerage accounts to engage in Automated Clearing House (ACH) "instant funds" abuse. FINRA has issued additional regulatory guidance concerning the increase of bad actors using compromised registered representative or employee email accounts to execute transactions or move money; using customer information to gain unauthorized entry to customers' email accounts, online brokerage accounts or both (*i.e.,* customer account takeover (ATO) incidents); and using synthetic identities to fraudulently open new accounts. FINRA will continue to assess firms' programs to protect sensitive customer and firm information, as well as share effective practices firms can employ to protect their customers and themselves. Where appropriate, FINRA will also share information about cybersecurity threats to firms.

Complex Products

FINRA will continue to review firms' communications and disclosures made to customers in relation to complex products, and will review customer account activity to assess whether firms' recommendations regarding these products are in the best interest of the retail customer given their investment profile and the potential risks, rewards and costs associated with the recommendation. In addition, in August of last year, FINRA launched a targeted exam to review members' practices and controls related to the opening of options accounts which, in some instances, may be used to engage in complex strategies involving multiple options (such as spreads). FINRA will share its findings from this review at a future date.

How to Use This 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 program 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.

- **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 prior Reports and that we 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.

- **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 (*e.g.,* Exam Findings Reports, 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 that extend beyond the requirements of existing federal securities provisions or FINRA rules.

Firm Operations

Anti-Money Laundering

Regulatory Obligations and Related Considerations

Regulatory Obligations:

The Bank Secrecy Act (BSA) and implementing regulations form the foundation for member firms' Anti-Money Laundering (AML) obligations. (The BSA has been amended several times, including by the USA PATRIOT ACT of 2001 and the Anti-Money Laundering Act of 2020.) **The implementing regulations impose a number of requirements on broker-dealers, which include implementing and maintaining both AML programs and Customer Identification Programs (CIPs); filing reports of suspicious activity; verifying the identity of legal entity customers; maintaining procedures for conducting ongoing customer due diligence; establishing due diligence programs to assess the money laundering risk presented by correspondent accounts maintained for foreign financial institutions; and responding to information requests from the Financial Crimes Enforcement Network (FinCEN) within specified timeframes.**

FINRA Rule 3310 (Anti-Money Laundering Compliance Program) requires that members develop and implement a written AML program reasonably designed to comply with the requirements of the BSA and its implementing regulations. **FINRA Rule 3310 also requires FINRA member firms to, among other things, establish and implement policies, procedures and internal controls that can be reasonably expected to detect and cause the reporting of suspicious activity; provide for an independent test of the AML program each calendar year (or every two years in some specialized cases); and provide ongoing training for appropriate personnel.**

Related Considerations:

- Does your firm's AML program reasonably address your business model, new and existing business lines, products, customers, geographic locations and associated AML risks?
- **Has your firm experienced substantial growth or changes to its business? If so, has its AML program reasonably grown and evolved alongside the business?**
- **Do your firm's AML procedures recognize that the suspicious activity reporting obligation may apply to any transactions conducted by, at or through the firm, even transactions that do not originate with your firm's customers?**
- **Does your firm have appropriately designed AML procedures to identify and respond to known indicators of suspicious activity involving low-priced securities, such as those detailed in FINRA *Regulatory Notices* *19-18* and *21-03*?**
- Does your firm's independent AML testing confirm that it maintains and implements reasonably designed procedures for suspicious activity detection and reporting?
- Does your firm collect identifying information and verify the identity of all individuals and entities that would be considered customers under the CIP Rule, and beneficial owners of legal entity customers under the Customer Due Diligence (CDD) Rule?
- **If your firm uses automated surveillance systems for suspicious activity monitoring, does your firm review the integrity of its data feeds and assess scenario parameters as needed?**
- If your firm introduces customers and activity to a clearing firm, how does your firm coordinate with your clearing firm, including with respect to the filing of Suspicious Activity Reports (SARs)?

- **Has your firm established and implemented appropriate procedures to: communicate cyber events to its AML department, Compliance department or both; fulfill regulatory obligations, such as the filing of SARs; and inform reviews of potentially impacted customer accounts?**
- **Has your firm reviewed FinCEN's first government-wide priorities for AML and countering the financing of terrorism (AML/CFT) policy ("AML/CFT Priorities"), and considered how the AML/CFT Priorities will be incorporated into its risk-based AML program?**

Emerging Low-Priced Securities Risk

FINRA has observed an increase in several types of activity in low-priced securities that could be indicative of fraud schemes—including an increase in such activity through foreign financial institutions (FFIs) that open omnibus accounts at U.S. broker-dealers. Recent trends indicate that FFIs may be "nesting"[2] within omnibus accounts of financial institutions based in jurisdictions that are generally considered to be lower risk, such as Canada or the United Kingdom.

To assist member firms in detecting and preventing these schemes—as well as mitigating the harm they cause to investors and the market—FINRA is sharing some of the signs of potentially illicit trading activity in low-priced securities that it has recently observed, which include:

- trading that coincides with a sudden increase in share price or trading volume, in the absence of legitimate news surrounding the company;
- investors depositing large blocks of shares of low-priced securities originating from convertible debt acquired from the issuer or a third party, immediately selling the shares and then transferring the proceeds out of the account;
- transactions in securities of issuers making questionable claims regarding their products or services related to a recent, major event (*e.g.,* the COVID-19 pandemic) or a new trend (*e.g.,* cryptocurrency or non-fungible tokens (NFTs)) or both; and
- increased trading that overlaps with a surge in relevant promotional activity on social media, investor chat rooms and message boards.

Firms can find additional resources concerning potential warning signs of fraudulent activity:

- FINRA's Investor Alerts and Investor Insights webpages
- *Regulatory Notice 21-03* (FINRA Urges Firms to Review Their Policies and Procedures Relating to Red Flags of Potential Securities Fraud Involving Low-Priced Securities)
- *Regulatory Notice 19-18* (FINRA Provides Guidance to Firms Regarding Suspicious Activity Monitoring and Reporting Obligations)
- SEC's Staff Bulletin: Risks Associated with Omnibus Accounts Transacting in Low-Priced Securities
- SEC's Risk Alert on Compliance Issues Related to Suspicious Activity Monitoring and Reporting at Broker-Dealers

Exam Findings and Effective Practices

Exam Findings:

- **Inadequate Ongoing Monitoring and Reporting of Suspicious Transactions – Failing to establish and implement an AML program reasonably expected to detect and report suspicious activity in compliance with FINRA Rule 3310(a) by, for example:**
  - **not using AML reports or systems that accurately and reasonably capture potentially suspicious activity, and are free of data integrity issues;**
  - **not conducting and accurately documenting AML surveillance reviews;**
  - **not implementing appropriate risk-based procedures to understand the nature and purpose of customer relationships in order to develop a customer risk profile;**
  - **not implementing procedures that are reasonably designed to investigate inquiries from clearing firms that concern "red flags" of potentially suspicious activity;**
  - **not tailoring AML programs to risks presented by products, customers, business lines and transactions (*e.g.,* cash management products, low-priced securities trading) and wire and ACH transfers; and**
  - **not notifying AML departments of events that involve suspicious transactions (*e.g.,* cybersecurity events, account compromises or takeovers, new account fraud, fraudulent wires and ACH transfers).**
- **Inadequate AML Independent Tests – Failing to comply with FINRA Rule 3310(c) by conducting AML tests that fail to review key aspects of the AML program, are not performed within the required timeframe, are not completed by persons with the requisite independence or are not completed at all.**
- **Insufficient Compliance With Certain Requirements of the BSA – Failing to establish a risk-based CIP to verify the identity of each customer in compliance with FINRA Rule 3310(b), failing to verify the identity of the beneficial owners of legal entity customers in compliance with FINRA Rule 3310(f) or failing to conduct due diligence on correspondent accounts of foreign financial institutions in compliance with FINRA Rule 3310(b).**

Update on Initial Public Offerings (IPOs) of China-Based Issuers

FINRA has observed that some firms are underwriting IPOs and subsequent trading of issuers based in the People's Republic of China (China-based issuers), raising concerns that the investors in the IPOs may be serving as nominees for an undisclosed control person or persons. These IPOs are typically smaller in size (*i.e.,* less than $100 million) and listed on the lower qualification tiers of U.S. stock exchanges.

FINRA has observed red flags of potentially manipulative trading associated with how these investors open new accounts and trade these securities after the IPO is completed, including:

- numerous unrelated accounts being opened at the same time, including with similar banking information, physical addresses, email address domains and current employer (which is often associated with the IPO issuer);
- documents investors provide in order to open an account or verify source of funds that may have been altered or could be fictitious;
- wire transfers received into these accounts that exceed the financial wherewithal of the investor as indicated on their new account documents, exceed the value of the shares purchased in the IPO and are either sent from similar banks, or bank accounts that share certain identifying information (*e.g.,* employer of account holder, email domain);
- investor accounts being accessed by a different Internet Protocol (IP) or Media Access Control (MAC) address[3] than is known for the customer, granting log in and trading capabilities to a third party or both;
- multiple orders with substantial similar terms being placed at or around the same time by seemingly unrelated investors in the same security that is indicative of "spoofing" or "layering"; and
- investors engaging in trading activity that does not make economic sense.

Given the potential risks, firms underwriting these IPOs and whose customers trade in these securities after the IPO should carefully evaluate whether they have controls in place necessary to identify and report market manipulation, other abusive trading practices and potential AML concerns. Firms can find additional information regarding the risks associated with China-based issuers in recent statements from the SEC:

- Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited
- Disclosure Considerations for China-Based Issuers
- [Chairman Gensler's] Statement on Investor Protection Related to Recent Developments in China

Effective Practices:

- **Risk Assessments** – Conducting an initial, formal written risk assessment and updating it based on the results of AML tests, audits and changes in size or risk profile of the firm (*e.g.,* business lines, products and services, registered representatives and customers).
- **Verifying Customers' Identities When Establishing Online Accounts – In meeting their CIP obligations, validating identifying information or documents provided by applicants (*e.g.,* Social Security number (SSN), address, driver's license), including, for example, through "likeness checks"; asking follow-up questions or requesting additional documents based on information from credit bureaus and credit reporting agencies, or digital identity intelligence (*e.g.,* automobile and home purchases); contracting third-party vendors to provide additional support (*e.g.,* databases to help verify the legitimacy of suspicious information in customers' applications); limiting automated approval of multiple accounts**

by a single customer; reviewing account applications for repetition or commonalities amongst multiple applications; and using technology to detect indicators of automated scripted attacks.[4]

- **Delegation and Communication of AML Responsibilities – When AML programs rely on other business units to escalate red flags of suspicious activity, establishing clearly delineated written escalation procedures and recurring cross-department communication with AML and compliance staff.**
- **Training – In meeting their obligations to provide ongoing AML training for appropriate personnel under FINRA Rule 3310(e), establishing and maintaining AML training programs that are tailored for the respective roles and responsibilities of the AML department, as well as departments that regularly work with AML; that address regulatory and industry developments impacting AML risk or regulatory requirements; and that, where applicable, leverage trends and findings from quality assurance controls.**
- **Detection and Mitigation of Wire and ACH Fraud** – In meeting their obligations to conduct ongoing monitoring to identify and report suspicious transactions under FINRA Rule 3310(f), monitoring outbound money movement requests post-ACH setup and restricting fund transfers in certain situations (*e.g.,* identity theft is detected in an investor's account).[5]

Additional Resources

- SEC
  - **Risk Alert: Compliance Issues Related to Suspicious Activity Monitoring and Reporting**
  - **Staff Bulletin: Risks Associated with Omnibus Accounts Transacting in Low-Priced Securities**
- FinCEN
  - **Advisory on Cybercrime and Cyber-Enabled Crime Exploiting the Coronavirus Disease 2019 (COVID-19) Pandemic**
  - **Advisory on Cyber-Events and Cyber-Enabled Crime**
  - **Advisory on Ransomware and the Use of the Financial System to Facilitate Ransom Payments**
  - **Anti-Money Laundering and Countering the Financing of Terrorism National Priorities**
  - **Frequently Asked Questions (FAQs) regarding the Reporting of Cyber-Events, Cyber-Enabled Crime, and Cyber-Related Information through Suspicious Activity Reports (SARs)**
- FINRA
  - Anti-Money Laundering (AML) Topic Page, which includes:
    - Anti-Money Laundering (AML) Template for Small Firms
    - ***Regulatory Notice 21-36* (FINRA Encourages Firms to Consider How to Incorporate the Government-wide Anti-Money Laundering and Countering the Financing of Terrorism Priorities Into Their AML Programs)**
    - ***Regulatory Notice 21-18* (FINRA Shares Practices Firms Use to Protect Customers from Online Account Takeover Attempts)**
    - ***Regulatory Notice 21-03* (FINRA Urges Firms to Review Their Policies and Procedures Relating to Red Flags of Potential Securities Fraud Involving Low-Priced Securities)**
    - ***Regulatory Notice 20-32* (FINRA Reminds Firms to Be Aware of Fraudulent Options Trading in Connection with Potential Account Takeovers and New Account Fraud)**
    - *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)

FinCEN National AML/CFT Priorities

As noted in *Regulatory Notice* 21-36, on June 30, 2021, FinCEN issued the AML/CFT Priorities, which identify and describe the most significant AML/CFT threats currently facing the United States (*e.g.,* cybercrime, domestic and international terrorist financing, securities and investment fraud).

The publication of the AML/CFT Priorities does not create an immediate change in BSA requirements or supervisory expectations for member firms, and FINRA is not currently examining for the incorporation of the AML/CFT Priorities into member firms' AML programs. Nevertheless, in preparation for any new requirements when the final regulations are effective, broker-dealers may wish to start considering how they will incorporate the AML/CFT Priorities into their risk-based AML programs.

Cybersecurity and Technology Governance

Regulatory Obligations and Related Considerations

Regulatory Obligations:

Rule 30 of the SEC's Regulation S-P 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 or issues related to an increase in trading volumes, can expose firms to operational failures that may compromise firms' ability to comply with a range of rules and regulations, including FINRA Rules 4370, 3110 (Supervision) and 4511 (General Requirements), as well as Securities Exchange Act of 1934 (Exchange Act) Rules 17a-3 and 17a-4.

Related Considerations:

Cybersecurity

- **What is the firm's process for continuously assessing cybersecurity and technology risk?**
- What kind of governance processes 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 and scanning of outbound emails to identify sensitive information?
- How does your firm identify and 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?
- **What types of penetration ("PEN") testing, if any, does your firm do to test web-facing systems that allow access to customer information or trading?**
- **How does your firm monitor for imposter websites that may be impersonating your firm or your registered representatives? How does your firm address imposter websites once they are identified?**
- **What are your firm's procedures to communicate cyber events to AML or compliance staff related to meeting regulatory obligations, such as the filing of SARs and informing reviews of potentially impacted customer accounts?**

Cybercrime

- FINRA continues to observe fraudsters and other bad actors engaging in cybercrime that increases both fraud risk (*e.g.,* synthetic identity theft, customer account takeovers, illegal transfers of funds, phishing campaigns, imposter websites) and money laundering risk (*e.g.,* laundering illicit proceeds through the financial system).
- Events involving, or enabled by, cybercrime are expected to be reported via SARs. FINRA has also published *Regulatory Notice* 21-18 (FINRA Shares Practices Firms Use to Protect Customers From Online Account Takeover Attempts), which discusses cybersecurity practices firms may find effective in mitigating risks related to ATOs and funds transfers.

Technology Governance

- 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 system or application 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 Findings and Effective Practices

Exam Findings:

- **Inadequate Risk Assessment Process – Not having an adequate and ongoing process to assess cyber and IT risks at the firm, including, for example, failing to test implemented controls or conducting PEN testing regularly.**
- **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 sensitive 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 ongoing comprehensive training to registered representatives, other firm personnel, third-party providers and consultants on cybersecurity risks relevant to individuals' roles and responsibilities (*e.g.,* 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).

Emerging Vendor Risk

Due to the recent increase in the number and sophistication of cyberattacks during the COVID-19 pandemic, FINRA reminds firms of their obligations to oversee, monitor and supervise cybersecurity programs and controls provided by third-party vendors.

Firms can find guidance in this area in *Regulatory Notice* 21-29 (FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors) and the Cybersecurity and Infrastructure Security Agency's (CISA) Risk Considerations for Managed Service Provider Customers.

- **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 multi-factor authentication (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, online account access and trading algorithm malfunctions due to a lack of testing for changes or system capacity issues.

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 regarding data access or data accumulation.
- **Incident Response Planning** – Establishing and regularly testing (often using tabletop exercises) a written formal incident response plan that outlines 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, mobile phones, 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 internal and third-party hardware and software changes, as well as system capacity, in order to protect non-public information and firm services.
- **Online System Capacity – Continuously monitor and test the capacity of current systems, and track average and peak utilization, to anticipate the need for additional resources based on increases in accounts or trading volumes, as well as changes in systems.**
- **Customer Account Access – Requiring customers to use MFA to access their online accounts.**

Additional Resources

FINRA's Cybersecurity Topic Page, including:

- ***Regulatory Notice 21-29* (FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors)**
- ***Regulatory Notice 21-18* (FINRA Shares Practices Firms Use to Protect Customers From Online Account Takeover Attempts)**
- *Regulatory Notice 20-32* (FINRA Reminds Firms to Be Aware of Fraudulent Options Trading in Connection With Potential Account Takeovers and New Account Fraud)
- ***Regulatory Notice 20-30* (Fraudsters Using Registered Representatives Names to Establish Imposter Websites)**
- *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
- Firm Checklist for Compromised Accounts
- Customer Information Protection Topic Page
- Cross-Market Options Supervision: Potential Intrusions Report Card
- 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:

- What methods does your firm use to identify individuals involved in undisclosed OBAs and PSTs?
- Do your firm's WSPs explicitly state when 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?

- **Upon receipt of a written notice of proposed OBAs, does your firm consider whether they will interfere with or otherwise compromise the registered person's responsibilities to the firm and the firm's customers, be viewed by customers or the public as part of the member's business or both? Does your firm also determine whether such activities should be treated as a PST (subject to the requirements of FINRA Rule 3280)?**
- Does your firm have a process in place to update a registered representative's Form U4 with activities that meet the disclosure requirements of that form?
- Does your firm take into account the unique regulatory considerations and characteristics of digital assets when reviewing digital asset OBAs and PSTs?
- Does your firm record PSTs for compensation on its books and records, including PSTs involving new or unique products and services?
- How does your firm supervise activities that are PSTs, including digital asset PSTs, and document its compliance with the supervisory obligations?

Exam Findings and Effective Practices

Exam Findings:

- **Incorrect Interpretation of Compensation** – 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 securities and tax benefits); and as a result, erroneously determining that certain activities were not PSTs.
- **Inadequate Consideration of Need to Supervise** – 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 the firm's 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 the firm's 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.
- **Inadequate Controls** – Inadequate controls to confirm adherence to limitations placed on OBAs or PSTs, such as prohibiting registered representatives from soliciting firm clients to participate in an OBA or PST.
- **No Review and Recordkeeping of Digital Asset Activities** – Failing to conduct the required assessment of OBAs that involve digital assets or incorrectly assuming all digital assets are not securities and therefore, not evaluating digital asset activities, including activities performed through affiliates, to determine whether they are more appropriately treated as PSTs; and for certain digital asset or other activities that were deemed to be PSTs for compensation, not supervising such activities or recording such transactions on the firm's books and records.

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" for issuers seeking new investors; and any expected revenues or other payments they receive from any entities other than the member firm, including affiliates).

- **Due Diligence** – Conducting due diligence to learn about all OBAs and PSTs at the time of a registered representative's initial disclosure to the firm and periodically thereafter, including interviewing the registered representative and thoroughly reviewing:
  - social media, professional networking and other publicly available websites, and other sources (such as legal research databases and court records);
  - email and other communications;
  - documentation supporting the activity (such as organizational documents); and
  - **OBAs that involve raising capital or directing securities transactions with investment advisers or fund companies in order to identify potential PSTs.** ★
- **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 selling compensation and in some cases providing FAQs to remind employees of scenarios that they might not otherwise consider to implicate these rules.
- **Training** – Conducting training on OBAs and PSTs during registered person and associated person onboarding and periodically thereafter, including regular reminders of written notice requirements and for registered persons to update their disclosures.
- **Disciplinary Action** – Imposing significant consequences—including heightened supervision, fines or termination—for persons who fail to notify firms in writing of their OBAs and PSTs, or fail to receive approval of their PSTs for compensation.
- **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* 21-25 (FINRA Continues to Encourage 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 the FINRA 4510 Rule Series (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."[6]

Additionally, firms must file a Financial Notification when selecting or changing an archival service provider, and are reminded to document the review of correspondence and confirm that individuals are not conducting supervisory reviews of their own correspondence. ★

Related Considerations:

- What kind of vendors, such as cloud service providers (Cloud Vendors), does your firm use to comply with Books and Records Rules requirements, including storing required records on electronic storage media (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 Rules policies and procedures to confirm they address all vendors, including Cloud Vendors?
- **If your firm emails its clients and customers links to Virtual Data Rooms (VDRs)—online data repositories that secure and distribute confidential information—does the firm retain and store documents embedded in those links once the VDRs are closed?**

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 firms 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 Rules, 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 vendors will provide the third-party attestation.

Additional Resources

- Frequently Asked Questions about the 2001 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

Direct Mutual Fund Business Risk

FINRA observed that some firms did not adequately supervise their direct mutual fund business (*i.e.,* selling mutual fund shares via "check and app" that are held directly by the mutual fund companies) because, for example, they were:

- maintaining blotters that did not include sufficient information to adequately supervise direct mutual fund transactions (*e.g.,* not all transactions are captured or key information is missing, such as customer name, fund symbol and share class);
- miscoding new mutual fund transactions as reinvestments or recurring contributions, which prevented them from going through firms' surveillance and supervision systems; and
- relying on *ad hoc* supervisory reviews by an insufficient number of designated principals.

As a result of these arrangements, many firms were unaware of, or had inadequate information about, direct mutual fund transactions that their registered representatives recommended or processed, and were not able to supervise them adequately. In some cases, this inability to supervise direct mutual fund business effectively resulted in firms not being able to identify inappropriate sales charge discounts, unsuitable share class recommendations and short-term mutual fund switching.

As part of their obligations under FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2110 (Recommendations), 3110 (Supervision) and Reg BI, firms must supervise all activity of their registered representatives related to direct mutual fund transactions. Additionally, Exchange Act Rules 17a-3 and 17a-4 require firms to maintain and keep current purchase and sale blotters that contain relevant information for all direct mutual fund transactions, including redemptions. When evaluating your firm's supervision of its direct mutual fund business, consider these questions:

- What portion of your firm's mutual fund business is application-based directly with mutual fund companies (in terms of dollar volume and number of accounts)?
- How do your firm's policies and procedures address supervision of your firm's direct mutual fund business? What processes (*e.g.,* regularly reviewing exception reports) does your firm use to review direct mutual fund transactions for compliance with applicable FINRA rules and securities regulations? Are such policies and procedures reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules?
- What information does your firm gather from mutual fund companies or clearing entities (*e.g.,* National Securities Clearing Corporation, Depository Trust and Clearing Corporation) to support its ability to adequately supervise its direct mutual fund business?

For additional guidance, please refer to *Regulatory Notice 21-07* (FINRA Provides Guidance on Common Sales Charge Discounts and Waivers for Investment Company Products).

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:

- Does your firm provide periodic reminders or training on such requirements, and what consequences does your firm impose on those persons who do not comply?
- How does your firm monitor for red flags of unreported written customer complaints and other reportable events?
- How does your firm confirm 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 written customer complaints, judgments concerning securities, commodities- or financial-related civil litigation 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 are the subject of any pending lawsuits or have received any written customer complaints).
- **Email Surveillance** – Conducting email surveillance targeted to identify unreported written customer 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 concerning securities, commodities- or financial-related civil litigation 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* 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

Firm Short Positions and Fails-to-Receive in Municipal Securities NEW FOR 2022

Regulatory Obligations and Related Considerations

Regulatory Obligations:

As detailed in *Regulatory Notice* 15-27, customers may receive taxable, substitute interest instead of the tax-exempt interest they were expecting when a firm effects sales to customers of municipal securities that are not under the firm's possession or control.[7] This can occur when firm trading activity inadvertently results in a short position or a firm fails to receive municipal securities it purchases to fulfill a customer's order.

Firms must develop and implement adequate controls and procedures for detecting, resolving and preventing these adverse tax consequences to customers. Such procedures must include closing out fails-to-receive within the time frame prescribed within Municipal Securities Rulemaking Board (MSRB) Rule G-12(h) and confirming that their communications with customers regarding the tax status of paid or accrued interest for municipal securities are neither false nor misleading, in accordance with MSRB Rule G-17.

Related Considerations:

- Does your firm use exception reports to manage its municipal securities' short positions or fails-to-receive? If so, how does your firm use such reports, and which departments are responsible for managing them?
- When municipal securities short positions are identified, does your firm begin to cover the shorts, or do they wait until the trades have settled?
- What is your firm's process to close out fails-to-receive in accordance with the methods and time frame prescribed under MSRB G-12(h)?
- How does your firm detect instances that would require them to pay customers substitute interest? In those circumstances, what is the firm's process for notifying impacted customers and paying them substitute interest in a timely manner? If a customer does not want to receive substitute interest, what alternatives does the firm offer (*e.g.,* offering to cancel the transaction and purchasing a comparable security that would provide tax-exempt interest)?
- How does your firm handle inbound or outbound account transfers sent through the Automated Customer Account Transfer Service (ACAT) that are delivered with no corresponding municipal bonds in possession or control?

Exam Findings and Effective Practices

Exam Findings:

- **Inadequate Controls and Procedures** – Not maintaining adequate procedures and controls for preventing, identifying and resolving adverse consequences to customers when a firm does not maintain possession or control of municipal securities that a customer owns.
- **Inadequate Lottery Systems** – Opting to use a random lottery system to allocate municipal short positions to certain customer accounts, but the system did not fairly or adequately account for or allocate substitute accrued interest payments.

Effective Practices:

- **Preventative Controls** – Maintaining processes to prevent or timely remediate municipal positions from settling short (*e.g.,* covering these positions, finding a suitable alternative, cancelling the customer's purchase).
- **Operational and Supervisory Reports** – Developing operational and supervisory reports to identify customer long positions for which the firm has not taken possession and control of the security.
- **Review of Fail Reports** – Municipal securities principals performing regular, periodic reviews of Fail Reports to comply with the close-out requirements of MSRB Rule G12-(h).

Additional Resource

- *Regulatory Notice* 15-27 (Guidance Relating to Firm Short Positions and Fails-to-Receive in Municipal Securities)

Trusted Contact Persons NEW FOR 2022

Regulatory Obligations and Related Considerations

Regulatory Obligations:

FINRA Rule 4512(a)(1)(F) (Customer Account Information) requires firms, for each of their non-institutional customer accounts, to make a reasonable effort to obtain the name and contact information for a trusted contact person (TCP) age 18 or older. FINRA Rule 4512 also describes the circumstances in which firms and their associated persons are authorized to contact the TCP and disclose information about the customer account.

Related Considerations:

- Has your firm established an adequate supervisory system, including WSPs, related to seeking to obtain and using the names and contact information for TCPs?
- Does your firm educate registered representatives about the importance of collecting and using trusted contact information, where possible?

Exam Findings and Effective Practices

Exam Findings:

- **No Reasonable Attempt to Obtain TCP Information** – Not making a reasonable attempt to obtain the name and contact information of a TCP for all non-institutional customers (*e.g.,* seeking to obtain this information only from senior non-institutional customers, not requesting this information within firm's regularly scheduled 36-month customer account records update letter).

- **No Written Disclosures** – Not providing a written disclosure explaining the circumstances under which the firm may contact a TCP when seeking to obtain TCP information (*e.g.,* when a new non-institutional account is opened or when the firm updates an existing account's information (in accordance with FINRA Rule 4512(b))).

Effective Practices:

- **Training** – Conducting training, for both front office and back office staff, on the warning signs of potential: (1) customer exploitation; (2) diminished capacity; and (3) fraud perpetrated on the customer.
- **Emphasizing the Importance of TCP and Promoting Effective Practices** –
  - Emphasizing at the senior-management level on down the importance of collecting TCP information.
  - Using innovative practices, such as creating target goals for collecting TCP and internally publicizing results among branch offices or regions.
  - Promoting effective ways of asking for TCP information and seeking feedback from registered representatives and supervisors on techniques that they have successfully used that have not already been publicized across the organization.
  - Establishing a system that notifies registered representatives when accessing non-institutional customer accounts that do not have a TCP listed and reminds them to request that information from customers.
- **Senior Investor Specialists** – Establishing specialized groups or appointing individuals to handle situations involving elder abuse or diminished capacity; contact customers' TCPs—as well as Adult Protective Services, regulators and law enforcement, when necessary—and guiding the development of products and practices focused on senior customers.
- **Firm Outreach** – Hosting conferences or joining industry groups focused on protecting senior customers.

Additional Resources

- SEC's, NAASA's and FINRA's Investor Resources for Establishing a Trusted Contact
- FINRA's Frequently Asked Questions Regarding FINRA Rules Relating to Financial Exploitation of Senior Investors
- *Regulatory Notice* 20-34 (Proposed Amendments to FINRA Rule 2165 and Retrospective Rule Review Report)

Emerging Customer Account Information Risks

Effective February 15, 2021, FINRA Rule 3241 (Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer) requires a registered person to decline being named a beneficiary of a customer's estate, executor or trustee, or to have a power of attorney for a customer unless certain conditions are met, including providing written notice to the firm and receiving approval. The rule requires the firm with which the registered person is associated, upon receiving required written notice from the registered person, to review and approve or disapprove the registered person assuming such status or acting in such capacity.

Registered persons face potential conflicts of interest when they are named a customer's beneficiary, executor or trustee, or hold a power of attorney for their customer. These conflicts of interest can take many forms and can include a registered person benefiting from the use of undue and inappropriate influence over important financial decisions to the detriment of a customer.

When assessing your firm's compliance with Rule 3241, consider these questions:

- Do your firm's policies and procedures establish criteria for determining whether to approve a registered person assuming either status or acting in either capacity?
- Does your firm perform a reasonable assessment of the risks created by a registered person being named a customer's beneficiary or holding a position of trust for a customer?
- If your member firm imposes conditions or limitations on its approval, does it reasonably supervise the registered person's compliance with the corresponding conditions or limitations?
- Does your firm have WSPs, and deliver training, reasonably designed to make registered persons aware of the obligations under the rule and the firm's related procedures?

Funding Portals and Crowdfunding Offerings NEW FOR 2022

Regulatory Obligations and Related Considerations

Regulatory Obligations:

Title III of the Jumpstart Our Business Startups (JOBS) Act enacted in 2012 contains provisions relating to securities offered or sold through crowdfunding. The SEC's Regulation Crowdfunding and FINRA's corresponding set of Funding Portal Rules set forth the principal requirements that apply to funding portal members.

Funding portals must register with the SEC and become a member of FINRA. Broker-dealers contemplating engaging in the sale of securities in reliance on the crowdfunding exemptions must notify FINRA in accordance with FINRA Rule 4518 (Notification to FINRA in Connection with the JOBS Act).

Related Considerations:

- What steps is your firm taking to confirm all required issuer information, pursuant to Regulation Crowdfunding Rules 201 and 203(a), is publicly available on your firm's platform?
- Does your firm plan to undergo or has it already undergone an operational or structural change that impacts the capitalization of the firm, pursuant to Funding Portal Rule 110(a)(4)? Has your firm reviewed the membership rules to confirm a Continuing Membership Application (CMA) is not required?

Exam Findings and Effective Practices

Exam Findings:

- **Failure to Obtain Attestation** – Not obtaining the attestation required by Regulation Crowdfunding Rule 404 when using a third-party vendor to store the required records.
- **Missing Disclosures** – Offerings on the platform do not contain all required disclosures as codified in Regulation Crowdfunding, in particular:
  - names of officers and directors of the issuer, and the positions held by these individuals for the past three years;
  - descriptions of the purpose and intended use of proceeds, the process to complete the offering transaction or cancel an investment commitment, the ownership and capital structure, the material terms of any indebtedness of the issuer; and
  - financial statements, as required by Regulation Crowdfunding Rule 201(t).
- **Failure to Report Customer Complaints** – Not reporting written customer complaints, as required by FINRA Funding Portal Rule 300(c).
- **Untimely Required Filings** – Not making required filings in a timely manner—such as filing the funding portal's Statement of Gross Revenue by the deadline of March 1—and not filing updates or changes to contact information within 30 days of the change.
- **Not Filing CMAs** – Funding portals effecting changes in ownership without obtaining prior approval from FINRA, as required by Funding Portal Rule 110(a)(4).

Effective Practices:

- **Compliance Resources** – Developing 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), as well as compliance checklists and schedules to confirm that required obligations are being met in a timely manner, such as providing all issuer disclosure requirements of Regulation Crowdfunding Rule 201.
- **Supervision** – Implementing supervisory review procedures tailored to funding portal communications requirements that, for example, clearly define permissible and prohibited communications and identify whether any contemplated structural or organizational changes necessitate the filing of a CMA.

Additional Resource

- FINRA's Funding Portals Topic Page

Communications and Sales

Reg BI and Form CRS

Regulatory Obligations and Related Considerations

Regulatory Obligations:

The SEC's Regulation Best Interest (Reg BI) establishes a "best interest" standard of conduct for broker-dealers and associated persons when they make recommendations to retail customers of any securities transaction or investment strategy involving securities, including account recommendations. **Pursuant to this standard, a broker-dealer and its associated persons must not put their financial or other interests ahead of the interests of a retail customer.**

In addition, whether or not they make recommendations, firms that offer services to retail investors must provide them with a Form CRS, a brief relationship summary that discloses material information in plain language (*e.g.,* investment services provided, fees, conflicts of interest, legal and disciplinary history of the firms and financial professionals).

Reg BI and Form CRS became effective on June 30, 2020, and 2021 marked the first full calendar year during which FINRA examined firms' implementation of related obligations. The findings presented here are thus an initial look at firms' practices. FINRA will share further findings as we continue to conduct exams and gather additional information on firms' practices.

Related Considerations:

- **When your firm determines whether it is obligated to comply with Reg BI, does your firm consider the following key definitions in the context of the rule?**
  - **"Retail customer" is defined as "a natural person, or the legal representative of such natural person, who:**
    - **receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer; and**
    - **uses the recommendation primarily for personal, family, or household purposes."**
  - **A retail customer "uses" a recommendation of a securities transaction or investment strategy involving securities when, as a result of the recommendation[8]:**
    - **the retail customer opens a brokerage account with the broker-dealer, regardless of whether the broker-dealer receives compensation;**
    - **the retail customer has an existing account with the broker-dealer and receives a recommendation from the broker-dealer, regardless of whether the broker-dealer receives or will receive compensation, directly or indirectly, as a result of that recommendation[9]; or**
    - **the broker-dealer receives or will receive compensation, directly or indirectly as a result of that recommendation, even if that retail customer does not have an account at the firm.**
- **Do your firm and your associated persons adhere to the Care Obligation of Reg BI when making recommendations by:**
  - **exercising reasonable diligence, care and skill to understand the potential risks, rewards and costs associated with a recommendation and having a reasonable basis to believe, based on that understanding, that the recommendation is in the best interest of at least some retail investors;**

  - **considering those risks, rewards and costs in light of the retail customer's investment profile and having a reasonable basis to believe that a recommendation is in that particular customer's best interest and does not place the broker-dealer's interest ahead of the customer's interest; and**
  - **having a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile?**
- **Do your firm and your associated persons consider costs and reasonably available alternatives when making recommendations to retail customers?**
- **Are your firm's policies and procedures reasonably designed to identify and disclose or eliminate conflicts, as well as to mitigate conflicts that create an incentive for an associated person of the firm to place his or her interests or the interest of the firm ahead of the retail customer's interest?**
- **How does your firm test its policies and procedures to determine if they are adequate and performing as expected?**
- Does your firm place any material limitations on the securities or investment strategies involving securities that may be recommended to a retail customer? If so, does your firm identify and disclose such limitations and prevent those limitations from causing the firm or its associated persons to make recommendations that place the firm's or associated person's interests ahead of the retail customer's interest?
- **Are your firm's policies and procedures reasonably designed to identify and eliminate sales contests, sales quotas, bonuses and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time, or mitigate conflicts for those not required to be eliminated?**
- **Do your firm's disclosures include a full and fair disclosure of all material facts relating to the scope and terms of the firm's relationship with retail customers (*e.g.,* material fees and costs associated with transactions or accounts, material limitations involving securities recommendations) and all material facts relating to conflicts of interest that are associated with the recommendation?**
- **What controls does your firm have to assess whether disclosures are provided timely, and if provided electronically, in compliance with the SEC's electronic delivery guidance?**
- **Do your firm's policies and procedures address Reg BI, including new obligations that did not exist prior to Reg BI?**
- **Do your firm's policies and procedures: (1) identify specific individual(s) who are responsible for supervising compliance with Reg BI; (2) specify the supervisory steps and reviews appropriate supervisor(s) should take and their frequency; and (3) note how supervisory reviews should be documented?**
- If your firm is not dually registered as an investment adviser, commodity trading advisor, municipal advisor or advisor to a special entity, do the firm or any of its associated persons who are not dually registered use "adviser" or "advisor" in their name or title?
- **Does the firm provide dually-registered associated persons with adequate guidance on how to determine and disclose the capacity in which they are acting?**
- Has your firm provided adequate Reg BI training to its associated persons, including supervisory staff?
- **If your firm offers services to retail investors:**
  - **does it deliver Form CRS to each new or prospective customer who is a retail investor before the earliest of: (i) a recommendation of an account type, securities transaction or investment strategy involving securities; (ii) placing an order for the retail investor; or (iii) opening a brokerage account for the investor?**

- **for existing retail investor customers, does the firm deliver Form CRS before or at the time the firm: (i) opens a new account that is different from the retail customer's existing account; (ii) recommends that the retail customer roll over assets from a retirement account; or (iii) recommends or provides a new service or investment outside of a formal account (*e.g.,* variable annuities or a first-time purchase of a direct-sold mutual fund through a "check and application" process)?**
- **does it file a relationship summary with the SEC through the Central Registration Depository (CRD), if the firm is registered as a broker-dealer; through the Investment Adviser Registration Depository (IARD), if the firm is registered as an investment adviser; or both CRD and IARD, if the firm is a dual-registrant?**
- **does your firm have processes in place to update and file the amended Form CRS within 30 days whenever any information becomes materially inaccurate and to communicate, without charge, any changes in the updated relationship summary to retail investors who are existing customers within 60 days after the updates are required to be made (a total of 90 days to communicate the changes to customers after the information becomes materially inaccurate)?**

Exam Findings and Effective Practices

Exam Findings:

Reg BI and Form CRS

- **WSPs That Are Not Reasonably Designed To Achieve Compliance with Reg BI and Form CRS –**
  - **Providing insufficiently precise guidance by:**
    - **not identifying the specific individuals responsible for supervising compliance with Reg BI; and**
    - **stating the rule requirements, but failing to detail how the firm will comply with those requirements (*i.e.,* stating "what" but failing to address "how").**
  - **Failing to modify existing policies and procedures to reflect Reg BI's requirements by:**
    - **not addressing how costs and reasonably available alternatives should be considered when making recommendations;**
    - **not addressing recommendations of account types;**
    - **not addressing conflicts that create an incentive for associated persons to place their interest ahead of those of their customers; and**
    - **not including provisions to address Reg BI-related recordkeeping obligations and the testing of the firms' Reg BI and Form CRS policies, procedures and controls.**
  - **Failing to develop adequate controls or developing adequate controls but not memorializing these processes in their WSPs.**
- **Inadequate Staff Training – Failing to adequately prepare associated persons to comply with the requirements of Reg BI beyond previous suitability obligations or Form CRS by:**
  - **failing to deliver initial training before the June 30, 2020, compliance date;**
  - **delivering training without making clear Reg BI's new obligations; or**
  - **delivering training that focused on Reg BI and Form CRS requirements in general, without addressing the specific steps associated persons should take to comply with these requirements.**

- **Failure to Comply With Care Obligation –**
  - **Making recommendations that were not in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards and costs associated with the recommendation.**
  - **Recommending a series of transactions that were excessive in light of a retail customer's investment profile and placing the broker-dealer's or associated person's interest ahead of those of retail customers.**
- **Failure to Comply with Conflict of Interest Obligation – Not identifying conflicts or, if identified, not adequately addressing those conflicts.**
- **Improper Use of the Terms "Advisor" or "Adviser" – Associated persons, firms or both, using the terms "advisor" or "adviser" in their titles or firm names, even though they lack the appropriate registration.[10]**
- **Insufficient Reg BI Disclosures – Not providing retail customers with "full and fair" disclosures of all material facts related to the scope and terms of their relationship with these customers or related to conflicts of interest that are associated with the recommendation, including:**
  - **material fees received as a result of recommendations made (*e.g.,* revenue sharing or other payments received from product providers or issuers, as well as other fees tied to recommendations to rollover qualified accounts);**
  - **potential conflicts of interest (*e.g.,* associated persons trading in the same securities in their personal account(s) or outside employment); and**
  - **material limitations in securities offerings.**

Form CRS

- **Deficient Form CRS Filings – Firms' Form CRS filings significantly departing from the Form CRS instructions or guidance from the SEC's FAQ on Form CRS by:**
  - **exceeding prescribed page lengths;**
  - **omitting material facts (*e.g.,* description of services offered; limitations of the firm's investment services);**
  - **inaccurately representing their financial professionals' disciplinary histories;**
  - **failing to describe types of compensation and compensation-related conflicts;**
  - **incorrectly stating that the firm does not provide recommendations;**
  - **changing or excluding language required by Form CRS; and**
  - **not resembling a relationship summary, as required by Form CRS.[11]**
- **Form CRS Not Posted Properly on Website – For firms that have a public website, failing to post or failing to post prominently, in a location and format that is easily accessible to retail investors, the current Form CRS (*e.g.,* requiring multiple click-throughs or using confusing descriptions to navigate to the Form CRS).**
- **Inadequate Form CRS Amendments – Firms not in compliance with Form CRS in relation to material changes because they:**
  - **failed to re-file in CRD in a timely manner (*i.e.,* within 30 days of the date when Form CRS became materially inaccurate); or**

- **failed to communicate or timely communicate changes to existing retail investor customers (*e.g.,* delivering amended summary, with required exhibits, showing revised text or summarizing material changes or communicating the information through another disclosure within 60 days after the updates are required to be made—90 days total from the date when Form CRS became materially inaccurate).**

- **Misconstruing Obligation to File Form CRS –**
  - **Incorrectly determining that filing Form CRS hinges solely on making recommendations, rather than offering services to a retail investor.**
  - **Incorrectly claiming a firm is not subject to the Form CRS delivery obligation because of, among other things, their customer base (*e.g.,* retail investors who are high-net-worth individuals) or the services they offer (*e.g.,* investment company products held directly by an issuer, self-directed accounts)**

Effective Practices:

- **Identifying and Mitigating Conflicts of Interest – Identifying, disclosing, and eliminating or mitigating conflicts of interest across business lines, compensation arrangements, relationships or agreements with affiliates, and activities of their associated persons by:**
  - **establishing and implementing policies and procedures to identify and address conflicts of interest, such as through the use of conflicts committees or other mechanisms or creating conflicts matrices tailored to the specifics of the firm's business that address, for example, conflicts across business lines and how to eliminate, mitigate or disclose those conflicts;**
  - **sampling recommended transactions to evaluate how costs and reasonably available alternatives were considered;**
  - **providing resources to associated persons making recommendations that account for reasonably available alternatives with comparable performance, risk and return that may be available at a lower cost, such as:**
    - **worksheets, in paper or electronic form, to compare costs and reasonably available alternatives; or**
    - **guidance on relevant factors to consider when evaluating reasonably available alternatives to a recommended product (*e.g.,* similar investment types from the issuer; less complex or risky products available at the firm);**
  - **updating client relationship management (CRM) tools that automatically compare recommended products to reasonably available alternatives;**
  - **revising commission schedules within product types to flatten the percentage rate; and**
  - **broadly prohibiting all sales contests.**

- **Limiting High-Risk or Complex Investments for Retail Customers – Mitigating the risk of making recommendations that might not be in a retail customer's best interest by:**
  - **establishing product review processes to identify and categorize risk and complexity levels for existing and new products;**
  - **limiting high-risk or complex product, transaction or strategy recommendations to specific customer types; and**
  - **applying heightened supervision to recommendations of high-risk or complex products.**

- **Implementing Systems Enhancements for Tracking Delivery of Required Customer Documents – Tracking and delivering Form CRS and Reg BI-related documents to retail investors and retail customers in a timely manner by:**
  - **automating tracking mechanisms to determine who received Form CRS and other relevant disclosures; and**
  - **memorializing delivery of required disclosures at the earliest triggering event.**
- **Implementing New Surveillance Processes – Monitoring associated persons' compliance with Reg BI by:**
  - **conducting monthly reviews to confirm that their recommendations meet Care Obligation requirements, including system-driven alerts or trend criteria to identify:**
    - **account type or rollover recommendations that may be inconsistent with a customer's best interest;**
    - **excessive trading; and**
    - **sale of same product(s) to a high number of retail customers;**
  - **monitoring communication channels (*e.g.*, email, social media) to confirm that associated persons who were not investment adviser representatives (IARs) were not using the word "adviser" or "advisor" in their titles; and**
  - **incorporating Reg BI-specific reviews into the branch exam program as part of overall Reg BI compliance efforts, focusing on areas such as documenting Reg BI compliance and following the firms' Reg BI protocols.**

Additional Resources

- FINRA's SEC Regulation Best Interest Key Topics Page
- SEC's Regulation Best Interest Guidance Page
- SEC's Staff Statement Regarding Form CRS Disclosure
- 2021 FINRA Annual Conference: Regulation Best Interest and Form CRS: Recent Observations and What to Expect Panel
- 2021 Small Firm Virtual Conference: Regulation Best Interest and Form CRS Panel
- You may submit a question by email to IABDQuestions@sec.gov. Additionally, you may contact the SEC's Division of Trading and Markets' Office of Chief Counsel at (202) 551-5777.

Areas of Concern Regarding SPACs

Over the past year, FINRA's review of firms participating in SPAC offerings has focused on the following.

Due Diligence – When firms and associated persons act as underwriter, qualified independent underwriter or syndicate member for a SPAC offering, the due diligence conducted at the IPO and merger stages, including as to the relevant officers, directors and control persons of the SPAC and SPAC-sponsor(s) and pre-identified acquisition targets.

Reg BI – Written policies and procedures or guidance on recommendations to retail customers, and supervisory systems designed to identify and address conflicts of interest presented by the involvement of the firm, their associated persons or both.

Disclosure – Firms' supervision of associated persons who hold positions with, advise or personally invest in SPACs or SPAC sponsors, and whether the associated persons are disclosing their involvement if required by FINRA rules governing OBAs, PSTs and Form U4 amendments.

Net Capital – In firm-commitment underwritings, whether firms are correctly taking net capital charges relative to the size of their commitment or using a written agreement with another syndicate member (*i.e.,* "backstop provider").

WSPs and Supervisory Controls – whether firms are maintaining and regularly updating their WSPs and supervisory controls to address risks related to SPACs (*e.g.,* Reg BI, due diligence, information barrier policies, conflicts of interest).

In October 2021, FINRA initiated a targeted review to explore the above areas and other issues relating to SPACs. Additional review areas include training; the use of qualified independent underwriters; underwriting compensation; services provided to SPACs, their sponsors or affiliated entities; and potential merger targets. It is anticipated that, at a future date, FINRA will share with member firms its findings from this review.

Communications with the Public

Regulatory Obligations and Related Considerations

Regulatory Obligations:

FINRA Rule 2210 (Communications with the Public) defines 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. **New member firms are required to file retail communications with FINRA's Advertising Regulation Department during their first year of membership.** ★

FINRA Rule 2220 (Options Communications) governs members' communications with the public concerning options. Additionally, MSRB Rule G-21 (Advertising by Brokers, Dealers or Municipal Securities Dealers) contains similar content standards relating to municipal securities or concerning the facilities, services or skills of any municipal dealer.

Related Considerations:

- **General Standards –**
  - Do your firm's communications contain false, misleading or promissory statements or claims?
  - 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 predictions or projections of investment performance to investors that are generally prohibited by FINRA Rule 2210(d)(1)(F)?
- **Mobile Apps –**
  - **Has your firm established and implemented a comprehensive supervisory system for communications through mobile apps?**
  - **Have you tested the accuracy of account information, including labels and data, displayed in your mobile apps?**
  - **Do your mobile apps accurately describe how their features work?**
  - **Do your mobile apps identify information in ways that are readily understandable, based on the experience level of your customers?**
  - **Do your mobile apps provide investors with readily available information to explain complex strategies and investments and associated risks?**
  - **If your firm offers an app to retail customers, does the information provided to customers constitute a "recommendation" that would be covered by Reg BI, and in the case of recommendations of options or variable annuities, FINRA Rules 2360 (Options) or 2330 (Members' Responsibilities Regarding Deferred Variable Annuities)? If so, how does your firm comply with these obligations?**
- **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 Books and Records Rules for all approved digital communications?
  - Does your firm have a process to confirm that all business-related communications 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?
  - assure 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 accounts insured by the Federal Deposit Insurance Corporation (FDIC); and
    - FDIC insurance coverage applies to funds when held at 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
    - benefits and risks of participating in such programs?
- **Municipal Securities Communications – If your firm offers municipal securities, does it confirm that advertisements for such securities include the necessary information to be fair, balanced and not misleading, and do not include:**
  - **exaggerated claims about safety or misleading comparisons to US Treasury Securities;**
  - **statements claiming "direct access" to bonds in the primary market if the firm is not an underwriter; and**
  - **unwarranted claims about the predictability or consistency of growth or payments?**
- **If an advertisement includes claims of municipal securities being "tax free," does it also explain any applicable state, local, alternative minimum tax, capital gains or other tax consequences?**
- **If an advertisement advertises a "taxable equivalent" yield on a municipal security offering, does it provide sufficient information regarding the tax bracket used to make the calculation?**

Exam Findings and Effective Practices

Exam Findings:

- **False, Misleading and Inaccurate Information in Mobile Apps –**
  - **Incorrect or misleading account balances or inaccurate information regarding accounts' historical performance.**
  - **Sending margin call warnings to customers whose account balances were not approaching, or were below, minimum maintenance requirements.**
  - **Falsely informing customers that their accounts were not enabled to trade on margin, when the accounts were, in fact, margin enabled.**
  - **Misstating the risk of loss associated with certain options transactions.**
  - **Distributing false and misleading promotions through social media and "push" notifications on mobile apps that made promissory claims or omitted material information.**

- **Deficient Communications Promoting Digital Assets –**
  - **Falsely identifying the broker-dealer as the entity from whom digital assets may be purchased or creating confusion about which entity is offering digital assets by using identical or substantially similar names to the broker dealer's name.**
- **Misrepresentations in Cash Management Account Communications –**
  - **Misleading statements or claims that either state or imply the broker-dealer is a bank.**
  - Misleading or false claims that state or imply the Cash Management Accounts are "checking and savings accounts."
  - Inaccurate or misleading statements concerning the amount of FDIC insurance coverage provided to investor funds when they are held at a partner bank.
  - Incomplete or inaccurate claims concerning the amount of time it may take for customer funds to reach the bank accounts or be available to investors once deposited at a partner bank.
  - Inaccurate or misleading claims about the actual terms of the Cash Management Accounts.
  - **Failure to balance promotional claims with the risks of participating in such programs.**
- **Insufficient Supervision and Recordkeeping for Digital Communications** – 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 business-related digital communications methods not controlled by the firm, 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.
  - Not including a "readily apparent reference" and hyperlink to FINRA's BrokerCheck in such communications.
- **Municipal Securities Advertisements – Using false and misleading statements or claims about safety, unqualified or unwarranted claims regarding the expertise of the firm, and promissory statements and claims regarding portfolio growth.**

Effective Practices:

- **Comprehensive Procedures for Mobile Apps – Maintaining and implementing comprehensive procedures for the supervision of mobile apps, for example, that confirm:**
  - **data displayed to customers is accurate; and**
  - **information about mobile apps' tools and features complies with FINRA's communications and other relevant rules before it is posted to investors.**
- **Comprehensive Procedures for Digital Communications** – Maintaining and implementing procedures for supervision of digital communication channels, including:
  - **Monitoring of New Tools and Features** – Monitoring 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 them to take 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 that are needed to balance any statements or claims contained in a digital asset communication, 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:
  - **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.
  - **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.
  - **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.

- **Municipal Securities Advertisements – Maintaining and implementing procedures for firm municipal securities communications, including:**
  - **Prior Approval – Requiring prior approval of all advertisements concerning municipal securities by an appropriately qualified principal to confirm the content complies with applicable content standards.**
  - **Training – Providing education and training for firm personnel on applicable FINRA and MSRB rules and firm policies.**
  - **Risk Disclosure – Balancing statements concerning the benefits of municipal securities by prominently describing the risks associated with municipal securities, including credit risk, market risk and interest rate risk.**
  - **Review – Reviewing firms' communications to confirm that the potential benefits of tax features are accurate and not exaggerated.**

Additional Resources

- *Regulatory Notice* 21-25 (FINRA Continues to Encourage 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
- FINRA's Social Media Topic Page
- ***MSRB Notice 2019-07***
- ***MSRB Notice 2018-18***

Private Placements

Regulatory Obligations and Related Considerations

Regulatory Obligations:

In *Regulatory Notice* 10-22 (Obligations of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings), FINRA noted that members that recommend private offerings have obligations under FINRA Rule 2111 (Suitability) and FINRA Rule 3110 (Supervision) to conduct reasonable diligence 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." **Although FINRA's Suitability Rule continues to apply to recommendations to non-retail customers, it no longer applies to recommendations to retail customers. Instead, the SEC's Reg BI applies to recommendations to retail customers of any securities transaction or investment strategy involving securities, including recommendations of private offerings.**

Additionally, 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), and should also be aware of recent amendments to these rules.[12] ★

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 confirm that associated persons conduct reasonable diligence prior to recommending private placement offerings, including conducting further inquiry into red flags?
- How does your firm address red flags regarding conflicts of interest identified during the reasonable diligence process and in third-party due diligence reports?
- How does your firm manage the transmission of funds and amended terms in contingency offerings, including ensuring compliance with Securities Exchange Act Rules 10b-9 and 15c2-4, as applicable?

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 12 months after the offering closing date).
- **No Reasonable Diligence** – Failing to perform reasonable diligence of private placement offerings prior to recommending them to retail investors, including:
  - **failing to conduct an appropriate level of research, particularly when the firm lacks experience or specialized knowledge pertaining to an issuer's underlying business or when an issuer lacks an operating history;**
  - **relying unreasonably on the firm's experience with the same issuer in previous offerings;** and
  - failing to inquire into and analyze red flags identified during the reasonable-diligence process or in third-party due diligence reports.

Effective Practices:

- **Private Placement Checklist** – Creating checklists with—or adding to existing due diligence checklists—all steps, filing dates and related documentation requirements, noting staff responsible for performing functions and tasks and evidence of supervisory principal approval for the reasonable diligence process and 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 deemed material to a potential investor (such as liquidity restrictions).
- **Independent Verification** – Verifying information that is 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), in some cases with support from law firms, experts and other third-party vendors.

- **Identifying Conflicts of Interest** – Using firms' reasonable diligence processes to identify conflicts of interest (*e.g.,* firm affiliates or issuers whose control persons were also employed by the firm) and then addressing such conflicts (such as by confirming that the issuer prominently and comprehensively discloses these conflicts in offering documents or mitigating them by removing financial incentives to recommend a private offering over other more appropriate investments).
- **Responsibility for Reasonable Diligence and Compliance** – Assigning responsibility for private placement reasonable diligence and compliance with filing requirements to specific individual(s) or team(s) and conducting targeted, in-depth training about the firms' policies, process and filing requirements.
- **Alert System** – Creating a system that alerts responsible individual(s) and supervisory principal(s) about upcoming and missed filing deadlines.
- **Post-Closing Assessment** – Conducting reviews after the offering closes to ascertain whether offering proceeds were used in a manner consistent with the offering memorandum.

Additional Resources

- ***Regulatory Notice* 21-26 (FINRA Amends Rules 5122 and 5123 Filing Requirements to Include Retail Communications That Promote or Recommend Private Placements)**
- ***Regulatory Notice* 21-10 (FINRA Updates Private Placement Filer Form Pursuant to FINRA Rules 5122 and 5123)**
- ***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

Conservation Donation Transactions Risks

FINRA is seeing continued syndications of Conservation Donation Transactions (CDTs) investment programs among broker-dealers. CDTs commonly involve private placement offerings where investor returns are based on a share of tax savings from a charitable donation. In practice, CDTs involve unrelated investors acquiring an interest in a passthrough entity (*i.e.,* a partnership or limited liability company) owning unimproved land. Before year-end, the passthrough entity either grants a conservation easement—which forever limits future development of the land—or outright donates the land to a land trust. In exchange, the passthrough entity receives charitable donation tax deductions, which serve as a return on investment to investors and often have values based solely on land appraisals that are predicated on an alternative plan to develop the land, oftentimes the equivalent of four to more than 10 times the price paid to acquire the land. (Common CDTs involve syndicated conservation easement transactions (SCETs) or substantially similar, fee simple donations of land.)

Firms that engage in CDTs should consider the following questions to determine whether they meet regulatory obligations:

- Do the CDT sponsor, appraiser or other related service providers have any prior, adverse audit history?
- Do your firm's offering disclosures present potential conflicts of interest among sponsors, consultants, land developers, prior landowners, broker-dealers, and registered persons having employment or affiliated relationships?
- In compliance with Reg BI, does your firm:
  - consider reasonably available alternatives to any recommendation of CDTs (*i.e.,* the Care Obligation);
  - have policies and procedures to identify and—at a minimum—disclose or eliminate all conflicts of interest associated with the recommendation (*i.e.,* the Conflicts of Interest Obligation); and
  - have policies and procedures to identify and mitigate any conflicts of interest associated with recommendations of CDTs that create an incentive for an associated person to place the interest of the firm or the associated person ahead of the retail customer's interest?
- In compliance with SEA Rule 15c2-4, does your firm promptly transmit funds to either an escrow agent or a separate bank account (as CDTs are typically associated with contingent offerings)?
- How does your firm establish and document reasonable diligence of CDTs, including further inquiries in the presence of red flags (*e.g.,* CDTs resulting in donation deductions that are more than two-and-one-half times an investor's investment, concerns surfaced in third-party due diligence reports, large markups associated with land acquisition, certain types of fees to related parties, marketing communications promoting CDTs solely on their tax benefits)?

For additional guidance, please refer to these resources:

- FINRA, 2018 Report on Examination Findings – Reasonable Diligence for Private Placements (Dec. 7, 2018)
- United States Senate, Report on Syndicated Conservation-Easement Transactions
- Internal Revenue Service, IRS increases enforcement action on Syndicated Conservation Easements (Nov. 12, 2019)
- Internal Revenue Service, IRS concludes "Dirty Dozen" list of tax scams for 2019: Agency encourages taxpayers to remain vigilant year-round (Mar. 20, 2019)
- Land Trust Alliance, Important Advisory: Tax Shelter Abuse of Conservation Donations (Feb. 1, 2018)
- Internal Revenue Service, Notice 2017-10, Listing Notice – Syndicated Conservation Easement Transactions

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. 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, Rule 2330 requires firms to establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the rule. Firms must implement surveillance procedures to determine if any associated person is effecting deferred variable annuity exchanges at a rate that might suggest conduct inconsistent with FINRA Rule 2330 and any other applicable FINRA rules or the federal securities laws.

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?
- How do your firm's WSPs support a determination that a variable annuity exchange has a reasonable basis? How do you obtain, evaluate and record relevant information, such as:
  - loss of existing benefits;
  - increased fees or charges;
  - surrender charges, or the establishment or creation of a new surrender period;
  - consistency of customer liquid net worth invested in the variable annuity with their liquidity needs;
  - whether a share class is in the customer's best interest, given his or her financial needs, time horizon and riders included with the contract; and
  - prior exchanges within the preceding 36 months?
- Do your firm's policies and procedures require registered representatives to inform customers of the various features of recommended variable annuities such as surrender charges, potential tax penalties, various fees and costs, and market risk?
- What is the role of your registered principals in supervising variable annuity transactions, including verifying how the customer would benefit from certain features of deferred variable annuities (*e.g.,* 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?
- **What is your firm's process to supervise registered representatives who advise their clients' decisions whether or not to accept a buyout offer?**

Exam Findings and Effective Practices

Exam Findings:

- **Exchanges** – Not reasonably supervising recommendations of exchanges for compliance with FINRA Rule 2330 and Reg BI, leading to 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.
- **Insufficient Training** – Not conducting training for registered representatives and supervisors regarding how to assess costs and fees, surrender charges and long-term income riders to determine whether exchanges were suitable for customers.
- **Poor and Insufficient Data Quality – Not collecting and retaining key information on variable annuity transactions, particularly in connection with exchange transactions; relying on processes for data collection and retention in situations where the volume of variable annuity transactions renders these processes ineffective; and failing to address inconsistencies in available data for variable annuities, as well as data formats and reporting processes.**
- **Issuer Buyouts** – Not reasonably supervising recommendations related to issuer buyout offers (*e.g.,* associated persons' recommendations that investors surrender the contract in order to generate an exchange or new purchase) for compliance with FINRA Rule 2230 and Reg BI.

Effective Practices:

- **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.
- **Automated Data Supervision – Creating automated solutions to synthesize variable annuity data (including general product information, share class, riders and exchange-based activity) in situations warranted by the volume of variable annuity transactions.**
- **Data Integrity** – Engaging with insurance carriers (affiliated and non-affiliated) and third-party data providers (*e.g.,* DTCC and consolidated account report providers) to address inconsistencies in available data, data formats and reporting processes for variable annuities.
- **Data Acquisition – Establishing a supervisory system that collects and utilizes key transaction data, including, but not limited to:**
  - **transaction date;**
  - **rep name;**
  - **customer name;**
  - **customer age;**
  - **investment amount;**
  - **whether the transaction is a new contract or an additional investment;**
  - **contract type (qualified vs. non-qualified);**

- **contract number;**
- **product issuer;**
- **product name;**
- **source of funds;**
- **exchange identifier;**
- **share class; and**
- **commissions.**

- **Data Analysis – Considering the following data points when conducting a review of an exchange transaction under FINRA Rule 2330 and Reg BI:**
  - **branch location;**
  - **customer state of residence;**
  - **policy riders;**
  - **policy fees;**
  - **issuer of exchanged policy;**
  - **exchanged policy product name;**
  - **date exchanged policy was purchased;**
  - **living benefit value, death benefit value or both, that was forfeited;**
  - **surrender charges incurred; and**
  - **any additional benefits surrendered with forfeiture.**

Additional Resources

- SEC
  - Regulation Best Interest, Form CRS and Related Interpretations
- FINRA
  - Regulation Best Interest (Reg BI) Topic Page
  - *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

Market Integrity

Consolidated Audit Trail (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; and timeliness, accuracy and completeness of data requirements. *Regulatory Notice* 20-31 (FINRA Reminds Firms of Their Supervisory Responsibilities Relating to CAT) describes 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: (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 your firm reports, or that is reported 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 your firm will self-report clock synchronization violations?
- Does your firm conduct daily reviews of the Industry Member CAT Reporter Portal (CAT Reporter Portal) to review file status to confirm the file(s) sent by the member or by their reporting agent was accepted by CAT and to identify and 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?
- **Does your firm maintain the required CAT order information as part of its books and records and in compliance with FINRA Rule 6890 (Recordkeeping)?**
- **How does your firm work with its clearing firm and third-party vendors to maintain CAT compliance?**

Exam Findings and Effective Practices

Exam Findings:

- **Inaccurate Reporting of CAT Orders – Submitting information that was incorrect, incomplete or both to the Central Repository, such as:**
  - **account holder type;**
  - **buy/sell side;**
  - **cancel quantity;**
  - **route event quantity (*e.g.,* reporting an old quantity that had been modified to a different amount);**

- **trading session code;**
- **new order code;**
- **department type code (*e.g.,* reporting "A" for agent, when the firm does not execute orders);**
- **time in force;**
- **handling instructions (*e.g.,* reporting new order events as Stop on Quote (SOQ) or Stop Limit on Quote (SLQ)); and**
- **representative indicator (*i.e.,* reporting the representative indicator to reflect a representative order when the order in a firm account was not created for the purpose of working one or more customer or client orders).**

- **Late Resolution of Repairable CAT Errors – Not resolving repairable CAT errors in a timely manner (*i.e.,* within the T+3 requirement).**
- **Inadequate Vendor Supervision – Not establishing and maintaining WSPs or supervisory controls regarding both CAT reporting and clock synchronization that are performed by third-party vendors.**

Effective Practices:

- **Supervision – Implementing a comparative review of CAT submissions versus firm order records; and utilizing CAT Report Cards and CAT FAQs to design an effective supervision process.**
- **Clock Synchronization Related to Third Parties – Obtaining adequate information from third parties to meet applicable clock synchronization requirements.[13]**

Additional Resources

- CAT NMS Plan
- FINRA
  - Consolidated Audit Trail (CAT) Topic Page
  - Equity Report Cards
  - *Regulatory Notice* 20-31 (FINRA Reminds Firms of Their Supervisory Responsibilities Relating to CAT)
  - *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)

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 firm and persons associated with a member firm 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. Where a firm may choose to not conduct an order-by-order review—to the extent consistent with Rule 5310 and associated guidance—it must have procedures in place to confirm it periodically conducts "regular and rigorous" reviews of the execution quality of its customers' orders.

Best execution obligations apply to any member firm that receives customer orders—for purposes of handling and execution—including firms that receive orders directly from customers, as well as those that receive customer orders from other firms for handling and execution, such as wholesale market makers.[14] These obligations also apply when a firm acts as agent for the account of its customer and executes transactions as principal. Any firm subject to FINRA Rule 5310 cannot transfer its duty of best execution to another person; additionally, any firm that routes all of its customer orders to another firm without conducting an independent review of execution quality would violate its duty of best execution.

Related Considerations:

- How does your firm determine whether to employ order-by-order or "regular and rigorous" reviews of execution quality?
- If applicable, how does your firm implement and conduct an adequate "regular and rigorous" review of the quality of the executions of its customers' orders and orders from a customer of another broker-dealer?
- If applicable, 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 compare the execution quality received under its existing order routing and execution arrangements (including the internalization of order flow) to the quality of the executions it could obtain from competing markets (whether or not the firm already has routing arrangements with them), including off-exchange trading venues?**
- **How does your firm address potential conflicts of interest in order routing decisions, including those involving:**
  - **affiliated entities (*e.g.,* affiliated broker-dealers, affiliated alternative trading systems (ATSs));**
  - **market centers, including off-exchange trading venues, that provide payment for order flow (PFOF) or other order-routing inducements; and**
  - **orders from customers of another broker-dealer for which your firm provides PFOF?**
- **If your firm provides PFOF to another broker-dealer, how does your firm prevent those payments from interfering with your firm's best execution obligations (including situations where you provide PFOF and execute the covered orders)?**
- If your firm engages in fixed income and options trading, has it established targeted policies and procedures to address 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?
- How does your firm meet 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 affecting pricing 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 in 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 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 orders to affiliated broker-dealers, affiliated ATSs, or market centers that provide routing inducements, such as PFOF from wholesale market makers and exchange liquidity rebates.

Targeted Reviews of Wholesale Market Makers

FINRA is conducting targeted best execution reviews of wholesale market makers concerning their relationships with broker-dealers that route orders to them as well as their own order routing practices and decisions (with respect to these orders). These targeted reviews are evaluating:

- whether wholesale market makers are conducting adequate execution quality reviews;
- whether order routing, handling and execution arrangements (including PFOF agreements) with retail broker-dealers have an impact on the wholesale marker makers' order handling practices and decisions, and fulfillment of their best execution obligations; and
- any modified order handling procedures that the wholesale market makers implemented during volatile or extreme market conditions.

Effective Practices:

- **Exception Reports** – Using exception reports and surveillance reports to support firms' efforts to meet their best execution obligations.
- **PFOF Order Handling Impact Review** – Reviewing how PFOF affects the order-handling 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 or more frequent basis (such as monthly), depending on the firm's business model.
- **Continuous Updates** – Updating WSPs and best execution analysis to address market and technology changes.

Additional Resources

- ***Regulatory Notice* 21-23 (FINRA Reminds Member Firms of Requirements Concerning Best Execution and Payment for Order Flow)**
- ***Regulatory Notice* 21-12 (FINRA Reminds Member Firms of Their Obligations Regarding Customer Order Handling, Margin Requirements and Effective Liquidity Management Practices During Extreme Market Conditions)**
- *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)
- FINRA Report Center
- Equity Report Cards
- Best Execution Outside-of-the-Inside Report Card

Disclosure of Routing Information NEW FOR 2022

Regulatory Obligations and Related Considerations

Regulatory Obligations:

Rule 606 of Regulation NMS requires broker-dealers to disclose information regarding the handling of their customers' orders in NMS stocks and listed options. These disclosures are designed to help customers: better understand how their firm routes and handles their orders; assess the quality of order handling services provided by their firm; and ascertain whether the firm is effectively managing potential conflicts of interest that may impact their firm's routing decisions.

Related Considerations:

- Does the firm publish accurate, properly formatted quarterly routing reports on its website for the required retention period as specified under Rule 606(a), including use of the SEC's most recently published PDF and XML schema?
- If the firm is not required to publish a quarterly report under Rule 606(a), does the firm have an effective supervisory process to periodically confirm that the firm has no orders subject to quarterly reporting?
- If the firm routes orders to non-exchange venues, does the firm adequately assess whether such venues are covered under Rule 606(a)?
- If the firm routes orders to non-exchange venues, does the firm obtain and retain sufficient information from such venues to properly report the material terms of its relationships with such venues, including specific quantitative and qualitative information regarding PFOF and any profit-sharing relationship?
- If the firm claims an exemption from providing not held order reports under Rule 606(b)(3) pursuant to Rule 606(b)(4) or (5), what policies and procedures does the firm have in place to determine if the firm's or a customer's order activity falls below the relevant *de minimis* thresholds?
- If the firm is required to provide customer-specific disclosures under Rule 606(b)(3), does the firm provide accurate, properly formatted disclosures for the prior six months to requesting customers within seven business days of receiving the request?

Exam Findings and Effective Practices

Exam Findings:

- **Inaccurate Quarterly Reports** – Publishing inaccurate information in the quarterly report on order routing, such as:
  - reporting only held orders in listed options, instead of both held and not held orders;
  - incorrectly stating that the firm does not have a profit-sharing arrangement or receive PFOF from execution venues;
  - not including payments, credits or rebates (whether received directly from an exchange or through a pass-through arrangement) in the "Net Payment Paid/Received" and "Material Aspects" sections of the quarterly report;
  - not including exchange pricing arrangements (*e.g.,* tiered pricing) in the "Net Payment Paid/Received" and "Material Aspects" sections of the quarterly report;
  - not disclosing any amounts of "Net Payment Paid/Received", when the firm receives PFOF for at least one of the four order types (*i.e.,* Market Orders, Marketable Limit Orders, Non-Marketable Limit Orders, Other Orders);
  - inaccurately identifying reported execution venues as "Unknown";
  - inaccurately identifying firms as execution venues (*e.g.,* identifying routing broker-dealer as execution venue, rather than the exchange where transactions are actually executed);

- incorrectly listing an entity as an execution venue when that entity does not execute trades (*e.g.,* firm that re-routes, but does not execute, orders; options consolidator that does not provide liquidity); and
- not posting the quarterly report on their firm's website in both required formats (*i.e.,* PDF and XML schema).

- **Incomplete Disclosures** – Not adequately describing material aspects of their relationships with disclosed venues in the Material Aspects disclosures portion of the quarterly report, such as:
  - inadequate descriptions of specific terms of PFOF and other arrangements (*e.g.,* "average" amounts of PFOF rather than specific disclosure noting the payment types, specific amount received for each type of payment, terms and conditions of each type of payment);
  - ambiguous descriptions of receipt of PFOF (*e.g.,* firm "may" receive payment);
  - inadequate or incomplete descriptions of PFOF received through pass-through arrangements;
  - incomplete descriptions of exchange credits or rebates; and
  - incomplete descriptions of tiered pricing arrangements, including the specific pricing received by the firm.
- **Deficient Communications** – Not notifying customers in writing of the availability of information specified under Rule 606(b)(1), as required by Rule 606(b)(2).[15]
- **Insufficient WSPs** – Either not establishing or not maintaining adequate WSPs reasonably designed to achieve compliance with the new requirements of Rule 606, including:
  - not updating their Disclosure of Order Routing Information WSPs to include new requirements detailed in amended Rule 606(a)(1) or new Rule 606(b)(3);
  - not describing the steps taken to review whether firms verified the data integrity of information sent to, or received from, their vendor—or not stating how the review would be evidenced by the reviewer;
  - not articulating a supervisory method of review to verify the accuracy, format, completeness, timely processing and details of the new Rule 606(b)(3) report, if requested, as well as documenting the performance of that review; and
  - not requiring the inclusion of detailed information regarding the routing and execution of the firm's customers' listed options orders in quarterly reports or customer-requested order routing disclosures.

Effective Practices:

- **Supervision** – Conducting regular, periodic supervisory reviews of the public quarterly reports and customer-specific order disclosure reports, if applicable, for accuracy (*e.g.,* assuring that per-venue disclosures of net aggregate PFOF and other payments are accurately calculated) and completeness (*e.g.,* assuring that the Material Aspects section adequately describes the firm's PFOF and other payment arrangement for each execution venue, including all material aspects that may influence the firm's order routing decisions).
- **Due Diligence on Vendors** – Performing due diligence to assess the accuracy of public quarterly reports and customer-specific order disclosure reports provided by third-party vendors by, for example, holding periodic meetings with vendors to review content of reports, comparing order samples against vendor-provided information, and confirming with the vendor that all appropriate order information is being received (particularly when the firm has complex routing arrangements with execution venues).

Additional Resources

- SEC's 2018 Amendments to Rule 606 of Regulation NMS
- SEC's Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS
- SEC's Staff Legal Bulletin No. 13A: Frequently Asked Questions About Rule 11Ac1-6
- SEC's Order Routing and Handling Data Technical Specification

Market Access Rule

Regulatory Obligations and Related Considerations

Regulatory Obligations:

Exchange Act Rule 15c3-5 (Market Access Rule) requires firms 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." **The Market Access Rule applies generally to securities traded on an exchange or alternative trading system, including equities, equity options, exchange-traded funds (ETFs), debt securities, security-based swaps, security futures products, as well as digital assets that meet the SEC's definition of a security.**

Related Considerations:

- If your firm has or provides market access, 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 market-wide 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 whether the vendor can meet the obligations of the rule?
- 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 its 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?
- **If your firm operates an ATS that has subscribers that are not broker-dealers, how does your firm comply with the requirements of the Market Access Rule, including establishing, documenting and maintaining a system of controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of this business activity?**

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, including those that transact fixed income transactions; not demonstrating the reasonability of assigned capital and credit pre-trade financial control thresholds; inadequate 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, unreasonable capital thresholds for trading desks, and unreasonable 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 or exchange, to apply their financial controls without performing adequate due diligence, not understanding how vendors' controls

operate, or both; and not maintaining direct and exclusive control over controls by allowing the ATS to unilaterally set financial thresholds for firms' fixed income orders without the involvement of the firm, 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 limits to their original values as needed.
- **Tailored Erroneous or Duplicative Order Controls** – Tailoring erroneous or duplicative order controls to particular products, situations or order types, and preventing the routing of market orders based on impact (Average Daily Volume Control) that are set at reasonable 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, potentially 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)
- FINRA's Algorithmic Trading Topic Page
- FINRA's Market Access Topic Page
- **SEC's Responses to Frequently Asked Questions Concerning Risk Management Controls for Brokers or Dealers with Market Access**

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 no less than the levels specified pursuant to the rule 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.

If firms have an affiliate paying any of their expenses, *Notice to Members* 03-63 (SEC Issues Guidance on the Recording of Expenses and Liabilities by Broker/Dealers) provides guidance for establishing an Expense Sharing Agreement that meets the standards set forth in Exchange Act Rule 17a-3[16]; firms with office leases should apply the guidance in *Regulatory Notice* 19-08 (Guidance on FOCUS Reporting for Operating Leases) for reporting lease assets and lease liabilities on their FOCUS reports. Additionally, firms must align its revenue recognition practices with the requirements of the Financial Accounting Standards Board's Topic 606 (Revenue from Contracts with Customers). ★

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 stipulations 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 sheets, 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 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

- **FASB**
  - **Revenue from Contracts with Customers (Topic 606)**
- FINRA
  - Funding and Liquidity Topic Page
  - **Interpretations to the SEC's Financial and Operational Rules**
  - ***Regulatory Notice 19-08*** **(Guidance on FOCUS Reporting for Operating Leases)**
  - *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)

Liquidity Risk 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 specified thresholds 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 and has shared observations on firms' liquidity risk management practices, as discussed in *Regulatory Notice* 15-33 (Guidance on Liquidity Risk Management Practices) and *Regulatory Notice* 21-12 (FINRA Reminds Member Firms of Their Obligations Regarding Customer Order Handling, Margin Requirements and Effective Liquidity Management Practices During Extreme Market Conditions). Additionally, FINRA has adopted a new filing requirement—the Supplemental Liquidity Schedule—for firms with large customer and counterparty exposures. As noted in *Regulatory Notice* 21-31 (FINRA Establishes New Supplemental Liquidity Schedule (SLS)), the new SLS is designed to improve FINRA's ability to monitor for potential adverse changes in these firms' liquidity risk.

Related Considerations:

- What departments at your firm are responsible for liquidity management?
- How often does your firm review and adjust its assumptions regarding clearing deposits in its liquidity management plan and stress test framework?
- **Does your firm's liquidity management practices include processes for:**
  - **accessing liquidity during common stress conditions—such as increases in firm and client activities—as well as "black swan" events;**
  - **determining how the funding would be used; and**
  - **using empirical data from recent stress events to increase the robustness of its stress testing?**
- Does your firm's contingency funding plan take into consideration the amount of time needed to address margin calls from both customers and counterparties? Does your firm also take into consideration the type of transactions that are impacting the firm's liquidity?
- What kind of stress tests (*e.g.,* market or idiosyncratic) does your firm conduct? Do these tests include concentration limits within securities or sectors, and incorporate holdings across accounts held at other financial institutions?

Exam Observations and Effective Practices

Exam Observations:

- **Not Modifying Business Models** – Failing to incorporate the results of firms' stress tests into their business model.
- **Establishing Inaccurate Clearing Deposit Requirements – Incorrectly basing clearing deposit requirements on information that doesn't accurately represent their business operations (*e.g.,* using the amounts listed on FOCUS reports rather than spikes in deposit requirements that may have occurred on an intra-month basis).**
- **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 and the process for accessing liquidity during a stress event, as well as 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 condition and stressed conditions;
    - assumptions based on idiosyncratic and market-wide conditions;
    - early warning indicators and escalation procedures if risk limits are neared or breached; and
    - **material changes in market value of firm inventory over a short period of time.**
- **Stress Tests** – Conducting stress tests in a manner and frequency that consider the complexity and risk of the firm's business model, including:
  - assumptions specific to the firm's business (*e.g.,* increased haircuts on collateral pledged by firm, availability of funding from a parent firm) and based on historical data;
  - the firm's sources and uses of liquidity, and if these sources can realistically fund its uses in a stressed environment;
  - the potential impact of off-balance sheet items (*e.g.,* non-regular way settlement trades, forward contracts) on liquidity; and
  - periodic governance group review of stress tests.

Additional Resources

- ***Regulatory Notice* 21-31 (FINRA Establishes New Supplemental Liquidity Schedule (SLS))**
- ***Regulatory Notice* 21-12 (FINRA Reminds Member Firms of Their Obligations Regarding Customer Order Handling, Margin Requirements and Effective Liquidity Management Practices During Extreme Market Conditions)**
- *Regulatory Notice* 15-33 (Guidance on Liquidity Risk Management Practices)
- *Regulatory Notice* 10-57 (Funding and Liquidity Risk Management Practices)
- FINRA's Funding and Liquidity Topic Page

Credit Risk Management

Regulatory Obligations and Related Considerations

Regulatory Obligations:

FINRA has consistently reminded firms of the importance of properly managing credit risk and published *Notices* that offer guidance on effective funding and liquidity risk management practices (which are available in the "Additional Resources" section below). Risk exposures can arise from clearing arrangements, prime brokerage arrangements (especially fixed income prime brokerage), "give up" arrangements and sponsored access arrangements (discussed in the Market Access Rule section).

Further, firms should maintain a control framework where they manage credit risk and 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. In particular, Exchange Act Rule 17a-3(a)(23) requires firms that meet specified thresholds 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.

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 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

- *Regulatory Notice* 21-31 (FINRA Establishes New Supplemental Liquidity Schedule (SLS))
- *Regulatory Notice* 21-12 (FINRA Reminds Member Firms of Their Obligations Regarding Customer Order Handling, Margin Requirements and Effective Liquidity Management Practices During Extreme Market Conditions)
- FINRA's 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 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 delivering them 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 that 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 assure compliance with the Customer Protection Rule? Has the firm analyzed these controls and procedures to address potential concerns arising from acting 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:

- **Confirming Control Agreements** – 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 include 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 Asset Securities by Special Purpose Broker-Dealers, Exchange Act Release No. 34-90788 (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)

Portfolio Margin and Intraday Trading NEW FOR 2022

Regulatory Obligations and Related Considerations

Regulatory Obligations:

FINRA Rule 4210(g) (Margin Requirements) permits member firms to apply portfolio margin requirements—based on the composite risk of a portfolio's holdings—in margin accounts held by certain investors as an alternative to "strategy-based" margin requirements. Firms are required to monitor the risk of the positions held in these accounts during a specified range of possible market movements according to a comprehensive written risk methodology.

Related Consideration:

- Do the firm's policies and procedures for monitoring the risk of their investors' portfolio margin accounts comply with Rule 4210(g)(1), in particular:
  - maintaining a comprehensive written risk methodology for assessing the potential risk to the member's capital during a specified range of possible market movements of positions maintained in such accounts;
  - monitoring the credit risk exposure of portfolio margin accounts both intraday and end of day; and
  - maintaining a robust internal control framework reasonably designed to capture, measure, aggregate, manage, supervise and report credit risk exposure to portfolio margin accounts?

Exam Findings and Effective Practices

Exam Findings:

- **Inadequate Monitoring Systems** – Systems not designed to consistently identify credit risk exposure intra-day (*e.g.,* do not include defined risk parameters required to produce notifications or exceptions reports to senior management; require manual intervention to run effectively) or end of day (*e.g.,* cannot monitor transactions executed away in a timely manner).
- **Not Promptly Escalating Risk Exposures** – Staff failing to promptly identify and escalate incidents related to elevated risk exposure in portfolio margin accounts to senior management, in part due to insufficient expertise.
- **Insufficient WSPs** – Failing to maintain written supervisory procedures outlining intraday monitoring processes and controls.

Effective Practices:

- **Internal Risk Framework** – Developing and maintaining a robust internal risk framework to identify, monitor and aggregate risk exposure within individual portfolio margin accounts and across all portfolio margin accounts, including:
  - increasing house margin requirements during volatile markets in real-time;
  - conducting stress testing of client portfolios;
  - closely monitoring client fund portfolios' NAV, capital, profitability, client redemptions, liquidity, volatility and leverage to determine if higher margin requirements or management actions are required; and
  - monitoring and enforcing limits set by internal risk functions and considering trigger and termination events set forth in the agreement with each client.
- **Concentration Risk** – Maintaining and following reasonably designed processes (reflected in the firm's WSPs) and robust controls to monitor the credit exposure resulting from concentrated positions within both individual portfolio margin accounts and across all portfolio margin accounts, including processes to:
  - aggregate and monitor total exposure and liquidity risks with respect to accounts under common control;
  - identify security concentration at the aggregate and single account level; and
  - measure the impact of volatility risk at the individual security level.
- **Client Exposure** – Clearly and proactively communicating with clients with large or significantly increasing exposures, according to clearly delineated triggers and escalation channels established by the firm's WSPs; and requesting that clients provide their profit and loss position each month.

Additional Resource

- FINRA's Portfolio Margin FAQ

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

Firms 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 and effective practices noted in our Reports and determined whether their compliance programs have any gaps that could lead to the types of findings noted in those 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.

Endnotes

1. "Related Considerations" are intended to serve as a possible starting point in considering a firm's compliance program related to a topic. Firms should review relevant rules to understand the full scope of their obligations.
2. "Nesting" refers to FFIs indirectly gaining access to the U.S. financial system through another FFI's correspondent account at a U.S. financial institution. This practice can facilitate legitimate financial transactions, but member firms that maintain correspondent accounts with FFIs should have policies and procedures to identify and monitor for potentially illegitimate "nested" activity.
3. An IP address is a unique identifier assigned to an Internet-connected device, while a MAC is a unique identifier used to identify a specific hardware device at the network level.
4. *See Regulatory Notice 21-18* (FINRA Shares Practices Firms Use to Protect Customers From Online Account Takeover Attempts)
5. *See Regulatory Notice 20-13* (FINRA Reminds Firms to Beware of Fraud During the Coronavirus (COVID-19) Pandemic)
6. The SEC is proposing amendments to 17a-4 to allow for electronic records to be preserved in a manner that permits the recreation of an original record if it is altered, over-written, or erased. *See* the SEC's Proposed Rule: Electronic Recordkeeping Requirements for Broker-Dealers, Security-Based Swap Dealers, and Major Security-Based Swap Participants.
7. These regulatory obligations stem from Exchange Act Rule 15c3-3(d)(4) and MSRB Rules G-17 and G-27 (for firm shorts), and MSRB Rule G12-(h) (for fails-to-receive).
8. Reg BI also applies to certain recommendations that were not previously covered under suitability obligations (*e.g.,* account recommendations, implicit hold recommendations in the case of agreed-upon account monitoring).
9. When a retail customer opens or has an existing account with a broker-dealer, the retail customer has a relationship with the broker-dealer and is therefore in a position to "use" the broker-dealer's recommendation.
10. While the SEC presumes that the use of the term "adviser" or "advisor" in a name or title by an associated person of a broker-dealer who is not also a supervised person of an investment adviser is a violation of the Disclosure Obligation under Reg BI, it recognizes that usage may be appropriate under certain circumstances. *See* FINRA's Reg BI and Form CRS Checklist for examples of possible exceptions.
11. *See* the SEC's December 17, 2021 Staff Statement Regarding Form CRS Disclosures for additional observations.
12. *Regulatory Notice 21-10* summarized the recent updates to the 5122/5123 Notification Filing Form that became effective on May 22, 2021, and *Regulatory Notice 21-26* announced that, as of October 1, 2021, FINRA Rules 5122 and 5123 require member firms to file retail communications that promote or recommend a private placement offering that is subject to these rules' filing requirements with FINRA's Corporate Financing Department.
13. *See* CAT NMS Plan, FAQ R.2 for the types of information firms should obtain from third-party vendors to satisfy these requirements.
14. *See, e.g., Regulatory Notice 21-23*.
15. In addition to the order routing disclosures under Rule 606, Rule 607 of Regulation NMS requires firms to disclose their policies regarding PFOF and order routing when customers open accounts, and on an annual basis thereafter, so firms should consistently provide the same information in both types of disclosures.
16. Firms are reminded that any affiliate obligated to pay firm expenses must have the independent financial means to satisfy those obligations.

www.finra.org

22_0021.1—02/22

Social Media and the Rise of the Finfluencers
Monday, May 16, 2022
1:45 p.m. – 2:45 p.m.

Human behavior has evolved as a result of the pandemic. For the financial services industry, the rapid acceleration of digital adoption has dramatically changed the way we engage with each other and our clients. Join FINRA staff and industry panelists as they discuss how social media and social media influencers are affecting the industry. Panelists discuss new developments, effective compliance practices, and how their firms are managing social media obligations.

Moderator:
Stephanie Gregory
Associate Director
FINRA Advertising Regulation

Panelists:
Lisa Colone
Chief Counsel
FINRA Enforcement

Michael Gerena
Senior Director, National Cause Program
FINRA Member Supervision

Terrie Hanna
Vice President and Associate General Counsel
Fidelity Investments

Social Media and the Rise of the Finfluencers Panelists Bios:

Moderator:

Stephanie Gregory is Associate Director of the Complex Review Team in FINRA's Advertising Regulation Department. Ms. Gregory's primary responsibility is managing staff members dedicated to the review of matters involving complex products and novel regulatory concerns. Her team provides support to other FINRA departments in connection with firm examinations and enforcement proceedings that involve communications with the public. Ms. Gregory joined the Advertising Regulation Department in 2004. She received her bachelor's degree in Economics and Political Science from Boston University, and her law degree from Pennsylvania State University Dickinson School of Law.

Panelists:

Lisa Colone serves as Chief Counsel in FINRA's Enforcement Department. She joined FINRA in 2016 and served as Senior Regional Counsel until her promotion to Chief Counsel in May 2018. Prior to joining FINRA, Ms. Colone served as Deputy Chief of the Criminal Division at the U.S. Attorney's Office for the District of New Jersey. In that role, Ms. Colone supervised more than 35 Assistant U.S. Attorneys in the Office's Economic Crimes Unit, Asset Forfeiture and Money Laundering Unit, and General Crimes Unit. Prior to her promotion to the position of Deputy Chief, Ms. Colone served as the Chief of the General Crimes Unit at the U.S. Attorney's Office. Ms. Colone also served as the lead prosecutor on numerous criminal prosecutions. Ms. Colone graduated from the University of Virginia and the University of Virginia School of Law. Prior to joining the U.S. Attorney's Office, she was an associate at Cleary Gottlieb LLP. Ms. Colone also clerked for the Honorable Catherine C. Blake, U.S. District Judge for the District of Maryland.

Michael Gerena is Senior Director of FINRA's National Cause Program and is located in Long Island, New York. In this capacity, Mr. Gerena is currently responsible for leading the Cause Examination Program for all of the retail firm groupings. Within this role, he is responsible for overall operations of the department, including the development and implementation of strategic and tactical measures necessary to ensure timely, high-quality completion of the departments regulatory program. Mr. Gerena is also actively involved in several initiatives related to FINRA's National Cause Program and other FINRA-wide initiatives. Mr. Gerena's tenure at FINRA began in 2004 and prior to serving in his current position, he has served in a variety of staff and management roles, most recently serving as the Associate District Director managing the sales practice cause staff in the New York and Long Island offices. Prior to joining FINRA, Mr. Gerena worked as a Variable Annuity Suitability Analyst at a broker-dealer. Mr. Gerena graduated from the State University of New Yok at Oswego and completed the FINRA Certified Regulatory and Compliance Professional™ (CRCP™) program at Wharton.

Terrie J. Hanna is Vice President and Associate General Counsel in the Personal Investing and Wealth Management group of the legal department of Fidelity Investments. Since arriving at Fidelity in 2011, Ms. Hanna has supported the development of new retail brokerage and advisory products, with a focus on high net worth and financial planning. Currently, Ms. Hanna and her team provide primary legal support for the retail marketing and communications teams, including support of the firm's social media channels and digital engagement practices. Ms. Hanna began her career with the Boston-based firm of Foley Hoag LLP, practicing in the areas of corporate, securities and tax law, and later joined Dechert LLP to focus her practice on the financial services industry. She then served as counsel to the Brokerage Division of SunGard Data Systems, Inc. for eight years, providing regulatory and transactional support to the firm's regulated subsidiaries, before returning to Dechert where she represented broker-dealers and investment advisers. Ms. Hanna earned a J.D., *summa cum laude*, from Boston University School of Law in 1990, and

a M.B.A., *high honors*, from Boston University Graduate School of Management in 1991. She received a Bachelor of Arts, *cum laude*, from Colby College in 1985.

Social Media and the Rise of the Finfluencers

Panelists

- **Moderator**
  - Stephanie Gregory, Associate Director, FINRA Advertising Regulation
- **Panelists**
  - Lisa Colone, Chief Counsel, FINRA Enforcement
  - Michael Gerena, Senior Director, National Cause Program, FINRA Member Supervision
  - Terrie Hanna, Vice President and Associate General Counsel, Fidelity Investments

To Access Polling

- **Please get your devices out:**
  - Type the polling address, **https://finra.cnf.io/sessions/xeg8** into the browser or scan the QR code with your camera.

  - Select your polling answers.

Polling Question 1

1. Do you have a print subscription to the Wall Street Journal?
   a. Yes
   b. No

Polling address: **https://finra.cnf.io/sessions/xeg8**

Polling Question 2

2. Do you have a Facebook account?
   a. Yes
   b. No

Polling address: **https://finra.cnf.io/sessions/xeg8**

Polling Question 3

3. Do you have a TikTok account?
   a. Yes
   b. No

Polling address: **https://finra.cnf.io/sessions/xeg8**

Polling Question 4

4. Do you use Reddit?
   a. Yes
   b. No

Polling address: **https://finra.cnf.io/sessions/xeg8**

Frequently Asked Questions About Advertising Regulation

On This Page

^ Back to top

FINRA Rule 2210 Interpretive Guidance

BLOCK: Advertising Regulation - Interpretive Guidance FAQ

A. Definitions

A.1. Institutional Communications

A.1.1. Q. If a firm distributes an institutional communication to intermediaries that fall within the definition of "institutional investor" and labels the communication for use only with institutional investors, and an intermediary subsequently distributes the communication to retail investors, is the member then required to treat the communication as a retail communication?
A. Unless the firm becomes aware that the intermediary has distributed the communication to retail investors, or the firm has not adequately labeled the communication, the firm will not be required to treat the communication as retail. FINRA Rule 2210(a)(3) defines "institutional communication" as "any written (including electronic) communication that is distributed or made available only to institutional investors, but does not include a member's internal communications." FINRA Rule 2210(a)(4) (the definition of "institutional investor") states in part that "No member may treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded or made available to any retail investor."

For example, a broker-dealer that receives an institutional communication from a mutual fund underwriter is responsible for assuring that its associated persons do not forward the communication to retail investors. The "reason to believe" standard is not intended to require a mutual fund underwriter to audit recipient broker-dealers' use of institutional communications.

Assuming a firm adequately labels an institutional communication as being for institutional use only, the firm would not have reason to believe, absent other facts, that the communication will be distributed to retail investors. However, if the recipient broker-dealer informs the fund underwriter that it intends to distribute the communication to its retail customers, or the fund underwriter otherwise becomes aware of this practice, the fund underwriter must either treat the communication as a retail communication going forward, or cease distributing institutional communications to the recipient broker-dealer until it reasonably concludes that the broker-dealer has adopted appropriate procedures to prevent redistribution.

Posted: 5/22/15

A.1.2. Q. FINRA Rule 2210(a)(3) defines "institutional communication" to exclude a firm's internal communications. Does "internal communication" include training and educational material prepared for use with registered representatives of affiliated broker-dealers?
A. No. "Internal communication" refers to communications within a firm. If a firm uses material to train or educate registered representatives of other broker-dealers (whether affiliated or unaffiliated), the material would be considered an institutional communication.

Posted: 1/7/13

B. Principal Approval

B.1. Third Party Research Reports

B.1.1. Q. If a firm distributes only to institutional investors a third-party research report that does not qualify as an independent third-party research report pursuant to FINRA Rule 2241(a)(3), is the firm required to have a registered principal or supervisory analyst approve the report prior to distribution?
A. No. A third-party research report that is distributed only to institutional investors as defined in FINRA Rule 2210(a)(4) is considered an institutional communication under FINRA Rule 2210(a)(3). FINRA Rule 2210(b)(3) permits a firm to distribute an institutional communication without having a registered principal approve the communication prior to distribution, provided that the firm establishes and implements certain written procedures for the supervision and review of such communications.

FINRA Rule 2241(h)(1) requires a registered principal or supervisory analyst to review for compliance with the applicable provisions of Rule 2241(h) and approve third-party research reports distributed by the firm unless the report meets the definition of "independent third-party research report."[1] However, this rule is not intended to require registered principal or supervisory analyst approval of a third-party research report that meets the definition of institutional communication. Accordingly, a firm may supervise such a report in the same manner as any other institutional communication pursuant to FINRA Rule 2210(b)(3).[2]

Updated: 12/14/15

B.2. Business Development Companies

B.2.1. Q. Does a Series 26 registration (Limited Principal - Investment Company and Variable Contracts Products) qualify a principal to approve a retail communication concerning a BDC?
A. No. A BDC is not registered as an investment company under the Investment Company Act of 1940. Accordingly, the Series 26 registration does not qualify a principal to approve a retail communication concerning a BDC. To approve a retail communication concerning a BDC, the registered principal must possess either a Series 24 (General Securities Principal), a Series 9/10 (General Securities Sales Supervisor) or a Series 39 (Limited Principal - Direct Participation Programs) registration, if the BDC is structured as a direct participation program as defined in NASD Rule 1022(e)(2).[3]

Posted: 5/22/15

B.3. Questions concerning principal approval of non-promotional communications (see Section C.4.) and for social media posts in online interactive electronic forums (see section C.6.).

C. Filing Requirements and Filing Exclusions

C.1. Filing Requirements

C.1.1. Q. Is a firm required to file with FINRA a retail communication concerning a business development company (BDC) that is registered under the Securities Act?
A. Yes. BDCs fall within the definition of direct participation program under FINRA Rule 2310(a)(4). Accordingly, firms must file with FINRA retail communications concerning BDCs that are registered under the Securities Act within 10 business days of first use or publication pursuant to FINRA Rule 2210(c)(3)(B).

Posted: 5/22/15

C.1.2. Q. FINRA Rule 2210(c)(3)(E) requires a firm to file within 10 business days of first use or publication retail communications concerning any security that is registered under the Securities Act of 1933 and that is derived from or based on a single security, a basket of securities, an index, a commodity, a debt issuance or a foreign currency (registered structured products). What types of products does this filing requirement cover?
A. While it is not possible to list all registered structured products, examples include exchange-traded notes that are not registered under the Investment Company Act but are registered under the Securities Act, registered reverse convertibles, registered structured notes, registered principal protection notes, and any other registered security that includes embedded derivative-like features. See Regulatory Notice 12-03 for some examples of registered structured products.

The purpose of this filing requirement is to have firms file with FINRA retail communications about structured products that are registered under the Securities Act. It is not intended to create a duplicative requirement for retail communications that are already subject to filing, such as retail communications concerning mutual funds, closed-end funds, exchange-traded funds that are registered under the Investment Company Act, variable insurance products, direct participation programs or collateralized mortgage obligations.

While this filing requirement applies to retail communications concerning registered structured products, it does not apply to issuer-prepared prospectuses, including issuer-prepared free-writing prospectuses that are filed with the SEC.[4]

Posted: 1/7/13

C.2. Filing Exclusion for Non-Material Changes to Previously Filed Retail Communications

C.2.1. Q. If a firm has previously filed a retail communication and then decides to use the same communication in a different format, must the firm refile the communication as it appears in the new format?
A. No. FINRA Rule 2210(c)(7)(A) excludes from filing retail communications that previously have been filed with FINRA and that are used without material change. FINRA would not consider revising a retail communication to appear in a different format to be a material change, provided that the content has not materially changed. For example, if a firm has previously filed a retail communication in the format that it appears on a desktop or laptop computer, and the firm is redesigning the presentation to appear on a tablet or smart phone, the firm would not have to refile the version that will appear on a tablet or smart phone.

Posted: 5/22/15

C.2.2. Q. What if a firm uses responsive Web design technology[5] to deliver a retail communication in different formats depending on the device used by a customer? Must the firm file each version of the retail communication to show how it will appear on each device?
A. No. For the same reasons set forth in the answer to the previous question, FINRA would not consider delivery of the same content in a retail communication in different formats using responsive design technology to be a material change to the communication. Accordingly, a firm would only have to file the retail communication once.

Posted: 5/22/15

C.2.3. Q. If a firm previously filed a retail communication that was initially distributed in print form, and the firm later decides to post the same communication on its website, must the firm refile the website version of the retail communication with FINRA?
A. No, provided that the content of the website version of the retail communication appears without material change from the previously filed print version.

Posted: 5/22/15

C.2.4. Q. If a firm changes the color scheme of a previously filed retail communication, must the firm refile the new version of the retail communication?

A. No. FINRA would not regard merely changing the color scheme of a previously filed retail communication to be a material change to the communication.

Posted: 5/22/15

C.2.5. Q. Is a firm required to re-file retail communications concerning a mutual fund that changes its name, if the only changes to the previously filed communications are substitutions of the fund's new name for its old name?
A. No. Assuming the fund has changed its name in any required filings with the SEC, FINRA would not consider merely changing the fund's name from previously filed retail communications concerning the fund to be a material change to the communications.

Posted: 5/22/15

C.2.6. Q. If a mutual fund passes its five-year or ten-year anniversary since inception, and a firm adds a new line to previously filed retail communications that present fund performance to show the fund's five-year or ten-year performance record as required by SEC Rule 482, must the firm re-file the revised retail communications?
A. No. FINRA would not consider merely adding a fund's five-year or ten-year performance record as required by Rule 482 to previously filed retail communications to be a material change.

Posted: 5/22/15

C.2.7 Q. The SEC presumes that the use of the terms "adviser" or "advisor" in a name or title by a broker-dealer that is not also registered as an investment adviser, or an associated person that is not also a supervised person of an investment adviser, to be a violation of the capacity disclosure requirement under Regulation Best Interest. If a firm previously filed a retail communication with FINRA, but now needs to revise the communication to eliminate references to adviser or advisor in the firm's name or an associated person's title because of Regulation Best Interest's presumption, would the firm be required to re-file the communication with FINRA?
A. No. Provided that the only revisions to the previously filed retail communication are eliminating references to adviser or advisor in order to comply with Regulation Best Interest, the firm would not be required to re-file the communication. Under these facts, FINRA would not consider such revisions to be a material change.

Posted: 5/20/20

C.3. Filing Exclusion for Templates

C.3.1. Q. A firm acts as a principal underwriter of a mutual fund family, and each fund in the family offers multiple classes of shares. If the firm creates a separate fact sheet for each share class of every fund in the family, is the firm required to file every fact sheet with FINRA if the only differences between the fact sheets for each share class of a particular fund are a share class's sales load, fees and performance?
A. No. FINRA Rule 2210(c)(7)(B)(i) excludes from filing retail communications that are based on templates that were previously filed with FINRA the changes to which are limited to updates of more recent statistical or other non-narrative information. If a firm files fact sheets for all share classes of one fund in its fund family, and the share class fact sheets for other funds follow the same format in presenting sales load, fee and performance information, then the firm would not be required to file the fact sheet for each share class of the other funds in the family. Instead, pursuant to the filing exclusion for templates, the firm would be permitted to file the fact sheet for only one share class of each of the other funds in the fund family. The firm should indicate as part of its filing that it is relying on the filing exclusion for templates in cases where the firm is filing only one share class fact sheet for a particular fund.[6]

Posted: 5/22/15

C.4. Non-Promotional Communications

C.4.1. Q. Is a firm required to file with FINRA, or have a principal approve prior to use, a retail communication that is limited to market commentary concerning overall changes in the market on a particular day, or a discussion of economic news?
A. No. General market commentaries or economic discussions that are not used for the purpose of promoting a product or service of the firm would be considered retail communications that do not make any financial or investment recommendation or otherwise promote a product or service of the member. See FINRA Rules 2210(b)(1)(D)(iii) and 2210(c)(7)(C).

Posted: 5/22/15

C.4.2. Q. Is a firm required to file, or have a principal approve prior to use, a retail communication that merely explains factual information regarding an individual retirement account, qualified plan or 401(k) account?
A. No. These kinds of retail communications also would be considered to be non-promotional and thus not subject to the principal pre-use approval or filing requirements. See FINRA Rules 2210(b)(1)(D)(iii) and 2210(c)(7)(C).

Posted: 5/22/15

C.4.3. Q. Is a firm required to file, or have a principal approve prior to use, a retail communication that merely provides information to participants in an employee retirement plan as required by the Employee Retirement Income Security Act of 1974 (ERISA) or the current Department of Labor (DOL) rules under ERISA? For example, would a firm be required to file a retail communication that merely informs participants in an employee retirement plan of changes to the investment options that are available through the plan?

A. In most cases, no. A firm would not be required to file or have a principal approve prior to use a notice distributed to plan participants that is required by ERISA or DOL rules, such as a notice that merely informs the participants of investment options that will no longer be available through the plan as of a particular date, and the investment options that will replace the eliminated options.

FINRA would consider such a notice to be a retail communication that does not make any financial or investment recommendation or otherwise promote a product or service of the member. However, if the notice also includes performance or other information that describes the investment objectives of the new investment options, or otherwise includes a headline or other graphic or text that promotes these new options, the firm would be required to file the notice, unless this information is required by ERISA or DOL rules.[7]

Posted: 5/22/15

C.4.4. Q. Is a firm required to file its stationery or the business cards of its associated persons?

A. No. These communications are not subject to filing requirements.

Posted: 5/22/15

C.4.5. Q. Is a firm required to have a principal approve prior to use or file with FINRA a video posted online that does not recommend or promote a product or service of the firm? New

A. No. In accordance with the exceptions in FINRA Rules 2210(b)(1)(D)(iii) and (c)(7)(C), a firm is not required to have a principal approve prior to use or file with FINRA a video posted online that does not recommend or promote a product or service of the firm, provided that the firm supervises and reviews such videos in the same manner as correspondence pursuant to FINRA Rules 3110(b) and 3110.06 through .09.[8] For example, FINRA Rule 3110(b)(4) requires that a firm's written supervisory procedures include procedures for the review of electronic communications related to the firm's investment banking or securities business and such procedures must be appropriate for each firm's business, size, structure, and customers.

Posted: 9/30/21

C.5. Article Reprints

C.5.1. Q. If a firm wishes to distribute to its customers a reprint of an article concerning a product subject to one of the filing requirements that appeared in an unaffiliated magazine or newspaper, and the only change that the firm made to the article was to add the firm's name and any disclosures necessary to meet applicable regulatory standards, is the firm required to file the article reprint with FINRA?

A. No. If a firm merely adds its name to the reprint or adds disclosures required to make the reprint consistent with applicable regulatory standards, the firm is not required to file the reprint with FINRA pursuant to FINRA Rule 2210(c)(7)(I).[9]

Posted: 5/22/15

C.6. Social Media Posts in Online Interactive Electronic Forums

C.6.1. Q. Did the adoption of FINRA Rule 2210 change the exceptions from the principal pre-use approval and filing requirements for posts in the interactive electronic forum portions of social media as compared to the requirements under NASD Rule 2210?

A. No, these exceptions have not changed. NASD Rule 2210 included as a communication category public appearances, which was defined to include participation in an interactive electronic forum. NASD Rule 2210 did not require principals to approve public appearances prior to use, and did not require firms to file public appearances with FINRA.

FINRA Rule 2210 treats interactive electronic forum posts, such as social media status updates, as retail communications rather than public appearances; however, the rule specifically excludes these posts from both the principal pre-use approval requirements and the filing requirements. See FINRA Rules 2210(b)(1)(D)(ii) and 2210(c)(7)(M). Accordingly, these exceptions have not changed with respect to posts on interactive electronic forums, despite the fact that they are no longer considered public appearances for purposes of the rule.[10]

Posted: 5/22/15

D. Content Standards

D.1. Disclosure of Expense Reimbursement Arrangements in Mutual Fund Performance Advertising

D.1.1. Q. If a firm presents mutual fund performance information in a retail communication, and the fund's expenses are subsidized through a fee waiver or expense reimbursement arrangement, must the firm disclose this arrangement?

A. FINRA Rule 2210(d)(5)(A) requires retail communications and correspondence that present non-money market fund open-end management investment company performance data as permitted by Securities Act Rule 482 and Investment Company Act Rule 34b-1 to disclose, among other things, the fund's total annual operating expense ratio, gross of any fee waivers or expense reimbursements, as stated in the fund's prospectus fee table.

FINRA also permits a firm to present in performance communications the fund's subsidized expense ratio, as long as the firm presents both the gross and subsidized expense ratios in a fair and balanced manner. If a firm wishes to present a fund's subsidized expense ratio in correspondence or retail communications, the communication must disclose whether the fee waivers or expense reimbursements were voluntary or mandated by contract, and the time period, if any, during which the fee waiver or expense reimbursement obligation remains in effect.[11]

Posted: 5/22/15

D.1.2. Q. May a retail communication or correspondence concerning a mutual fund also include an "adjusted expense ratio" that illustrates the impact of interest and dividend expenses incurred by the fund from borrowings, repurchase agreements or investments in short sales?

A. Yes. Because interest and dividend expenses incurred from borrowings, repurchase agreements or investments in short sales (whether directly or through investments in underlying funds) are considered fund expenses under generally accepted accounting principles, they must be included in a fund's gross and net expense ratios disclosed in the prospectus fee table. Provided that the communication includes the fund's gross and net expense ratios, it also may include an "adjusted expense ratio" that is the fund's gross expense ratio reduced by any amounts contractually waived or reimbursed, and further reduced by interest and dividend expenses resulting from borrowings, repurchase agreements or investments in short sales. The communication should clearly label, and include a prominent plain English explanation of, the adjusted expense ratio, which should be presented separately from, and with no greater prominence than, the fund's gross and net expense ratios.

Posted: 12/2/19

D.2. Recommendations

D.2.1. Q. Do the disclosure requirements regarding recommendations apply to a mutual fund portfolio manager's discussion of the fund's past performance (such as a manager's discussion that accompanies an annual or semi-annual report)?

A. No. While these discussions must comply with FINRA Rule 2210, FINRA does not consider a portfolio manager's discussion of a fund's past performance to be a firm's recommendation of the individual securities included in the discussion.

Posted: 1/7/13

D.3. Provision of Related Performance Information

D.3.1. Q. FINRA's letter to Edward P. Macdonald, Hartford Funds Distributors, LLC ("Hartford"), dated May 12, 2015 ("Hartford Letter") interpreted FINRA Rule 2210 to allow Hartford to include Related Performance Information in communications concerning mutual funds that are distributed solely to institutional investors, as that term is defined in FINRA Rule 2210(a)(4), subject to enumerated representations and conditions. Provided that the presentation is consistent with the representations and conditions contained in the Hartford Letter, may a firm show Related Performance Information that is net of the fees and expenses of the advertised mutual fund?

A. Yes. In condition 5 of the Hartford Letter, Hartford represented that the presentation of Related Performance[12] Information will disclose performance information that is net of fees and expenses of Related Accounts[13], or net of a model fee that is the highest fee charged to any account managed in the strategy. Condition 5 also stated that the fees and expenses of the registered fund that is the subject of the institutional communication will be prominently disclosed and this fund's performance will reflect all fees and expenses. Condition 5 also stated that if the registered fund's fees and expenses are higher than the Related Accounts' fees and expenses, that fact will be disclosed.

A presentation of Related Performance Information that is net of all fees and expenses of the registered mutual fund that is the subject of an institutional communication, rather than the fees and expenses of the Related Accounts, is consistent with the intent of the Hartford Letter. The institutional communication must prominently disclose the fact that the Related Performance Information is shown net of the registered fund's fees and expenses and, if applicable, that the registered fund's fees and expenses are lower than those of the Related Accounts.

Posted: 3/9/17

D.3.2. Q. Is the Hartford Letter intended to allow the presentation of Related Performance Information in an institutional communication concerning an actively managed exchange-traded fund ("ETF") that is registered under the Investment Company Act of 1940?

A. Yes. A firm may present Related Performance Information in an institutional communication concerning an actively managed ETF, provided that this presentation is consistent with the representations and conditions contained in the Hartford Letter.

Posted: 3/9/17

D.4. Usability Study and Focus Group Communications

D.4.1. Q. If a firm distributes a communication solely for the purposes of recruiting individuals who might be part of a group to provide feedback or participate in a usability study (through a focus group or otherwise), or solely for the purposes of communicating a "blind" or anonymous survey, must the firm disclose its member name under Rule 2210(d)(3) in the communication?

A. No. Rule 2210(d)(3) expressly states that it does not apply to "blind" advertisements used to recruit personnel. Similarly, it would not apply in these recruiting and feedback situations in which using a member name would counteract the purpose of the communication.

Posted: 1/16/19

D.4.2. Q. If a firm distributes a communication solely to one or more individuals who are engaged to provide feedback concerning the communication or participate in a usability study concerning the communication (through a focus group or otherwise), and those individuals are informed that the communication is being provided solely for such purpose, would that communication be subject to Rule 2210 and its requirements?

A. No.

Posted: 1/16/19

D.5. Use of Hyperlinks in Electronic Communications New

D.5.1. Q. Does FINRA Rule 2210(d)(1)(A) permit a firm to include in electronic communications hyperlinks to content that provides additional information related to the communication in a fair and balanced manner?

A: Yes. FINRA Rule 2210(d)(1)(A) requires firm communications, among other things, to be fair, balanced, and not to omit any material fact or qualification if the omission would cause the communication to be misleading. Consistent with these standards, a firm may rely on a hyperlink to provide additional information or explanations so long as the initial electronic communication that includes the link is itself fair and balanced. For example, a non-misleading electronic communication about opportunities in emerging markets could link to an additional explanation about the basis for a claim in the initial post as well as the risks associated with emerging markets investments. However, a firm may not rely on linked explanations or disclosures to correct a communication that is, on its face false, misleading, exaggerated or promissory. [14] To the extent practicable in the given medium, the link itself, or the text within the communication that introduces the link, should state what will be provided through the link.

Historically, FINRA has interpreted the Communications with the Public Rules to permit hyperlinks to explanations and further information in a variety of situations. For example, FINRA Rule 2210 permits firms to use hyperlinks within banner advertisements to generate interest in a topic and provide more information through hyperlinks, [15] and FINRA has interpreted FINRA Rule 2210 to permit firms to link to required information about testimonials.[16]

This approach is also consistent with the treatment of hyperlinks in the Commission's recently adopted Investment Adviser Marketing rule under the Investment Advisers Act of 1940. [17] The Marketing Rule Adopting Release notes that the rule's use of "fair and balanced" is closely aligned with FINRA Rule 2210's general standards, and that investment advisers may use layered disclosure that employ hyperlinks to meet these requirements. [18]

Posted: 9/30/21

D.6. Internal Rate of Return (IRR) New

D.6.1. Q. Regulatory Notice 20-21 (FINRA Provides Guidance on Retail Communications Concerning Private Placement Offerings) interprets FINRA Rule 2210 to permit the inclusion of an internal rate of return (IRR) if it is calculated in a manner consistent with the Global Investment Performance Standards (GIPS®) adopted by CFA Institute and includes additional GIPS-required metrics such as paid-in capital, committed capital and distributions paid to investors. What is the distinction between calculating IRR in a "manner consistent with the GIPS standards" and "GIPS compliance"?

A. The guidance in *Regulatory Notice 20-21* that IRR be calculated in a "manner consistent with the Global Investment Performance Standards (GIPS)" refers to using the same primary inputs and calculation methodology articulated in the GIPS standards as well as including prominently in the communication the additional required metrics set forth in the GIPS standards. The primary inputs are external cash flows and the period-end value of the investment or terminal value. With respect to the calculation methodology, since-inception IRR can be calculated using common spreadsheet software and the extended IRR (XIRR) function. [19]

Firms that comply with all of the applicable requirements of the GIPS standards on a firm-wide basis may claim compliance with the GIPS standards (i.e., they are "GIPS compliant"). Firms are not required to claim compliance with GIPS or choose to have their firm verified in order to use IRR in private placement communications in a manner that is consistent with the requirements of FINRA Rule 2210.

While the GIPS standards generally prohibit firms from making any statement referring to the calculation methodology as being "in accordance," "in compliance," or "consistent" with the GIPS standards, CFA Institute has created a limited exception for firms and their agents in retail

communications concerning private placement offerings that are prepared in a manner consistent with FINRA Rule 2210 and the guidance in *Regulatory Notice 20-21*. [20]

It is also important to recognize that the requirement to present IRR calculated in a "manner consistent with the Global Investment Performance Standards (GIPS)" only applies to investment programs with ongoing operations that include a combination of realized and unrealized holdings.

When presented in a fair and balanced manner, realized historical performance for a completed investment program, whether expressed as IRR or any other return metric, will generally be consistent with the content standards in FINRA Rule 2210. In contrast, as stated in *Regulatory Notice 20-21*, IRR presented for privately placed new investment programs that have no operations or that operate as a blind pool is a projection prohibited by FIRNA Rule 2210(d)(1)(F).

Posted: 9/30/21

D.6.2. Q. If an investment program has both realized and unrealized holdings, may a firm show returns for each of the realized holdings without also showing the program's IRR?
A. Presenting returns solely for realized holdings in a program with ongoing operations without presenting the fund's IRR may be consistent with FINRA Rule 2210 provided that the information presented is fair and balanced. If a communication shows returns for any realized holding, then returns for each realized holding must be shown with equal prominence. "Cherry picking" or excluding returns for realized holdings that performed poorly would be misleading and inconsistent with FINRA Rule 2210(d)(1)(B).

In contrast, unrealized holdings have no actual performance experience, and any return metric would require its valuation to be estimated. Such metrics would represent a prohibited projection under FINRA Rule 2210(d)(1)(F).

Posted: 9/30/21

D.6.3 Q. May a firm aggregate realized holdings of an investment program together into an "aggregate realized investment" return without showing the total program's IRR?
A. As a general matter, it is misleading for a communication to include metrics that combine or average the performance of only the individual realized holdings. Such metrics may mask unequal or poor returns and the results may not be representative of the ultimate performance of the unrealized holdings or the program as a whole. This is the case whether or not the total fund IRR is included.

Posted: 9/30/21

D.6.4 Q. A firm wants to prepare a communication for an ongoing program that includes an IRR and the additional metrics required by the GIPS standards in accordance with *Regulatory Notice 20-21*. Is the firm allowed to also include information beyond what is required by the GIPS standards?
A. Generally, a firm may include information beyond what is required by the GIPS standards in a communication for an ongoing program. Any information must be presented in a fair and balanced manner, must not be misleading, and otherwise must be consistent with the content standards of FINRA Rule 2210(d).

Posted: 9/30/21

D.7. Prohibition on Predictions or Projections of Investment Performance New

D.7.1 Q. May a firm include in a retail private placement communication a "target return" to investors if the communication also includes the assumptions and key risks underlying the return?
A. FINRA Rule 2210(d)(1)(F) prohibits predictions or projections of performance, the implication that past performance will recur, and any exaggerated or unwarranted claim, opinion or forecast. As discussed in Regulatory Notice 20-21, "retail communications may not project or predict ***returns to investors*** such as yields, income, dividends, capital appreciation, percentages or any other future investment performance." This prohibition extends to retail communications that include target returns to investors. However, Regulatory Notice 20-21 makes clear that Rule 2210(d)(1)(F) does not prohibit reasonable forecasts of ***issuer operating metrics*** (e.g., forecasted sales, revenues or customer acquisition numbers) that may convey important information regarding the issuer's plans and financial position, provided that the retail communication provides a sound basis for evaluating the facts as required by Rule 2210(d)(1)(A). Such reasonable forecasts may take the form of target issuer operating metrics, so long as the retail communication does not provide a target return to investors. The Notice also provided guidance on the types of information that should be included, and the factors firms should consider, when creating, reviewing, approving or using forecasts of issuer operating metrics in retail communications.

Posted: 12/8/21

E. Limitations on Use of FINRA's Name

(No Q&As currently under this section)

F. Public Appearances

F.1. Supervision Updated

F.1.1. Q. If a registered representative makes a scripted presentation at a seminar for prospective retail investors, what is the responsibility of the firm with which the representative is associated to supervise the presentation?

A. A sales script used in a seminar is considered a retail communication under FINRA Rule 2210 (assuming the script is used with more than 25 retail investors within a 30 calendar-day period).

The firm with which the representative is associated is responsible for approving prior to use any retail communication used as part of the seminar presentation. If a retail communication is subject to a filing requirement under FINRA Rule 2210, the firm also must file the communication with FINRA. FINRA Rule 2210(f)(3) requires each firm to establish written procedures that are appropriate to its business, size, structure, and customers to supervise its registered representative's public appearance. These procedures must provide for education and training, documentation of such education and training, and surveillance and follow-up to ensure that representatives implement and adhere to the procedures.

Posted: 1/7/13

F.1.2 Q. Our firm's registered representatives may meet with groups either in person or using online conferencing platforms. How should firms supervise these meetings?

A. Firms must supervise registered representatives' live meetings with customer groups, whether in person or through an online conferencing platform, in a manner reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules, including FINRA Rule 2210(f). This rule provision sets forth supervision and content standards for public appearances such as seminars, forums, media interviews or other public speaking activities that are unscripted and do not constitute retail communications, institutional communications, or correspondence.

Posted: 9/30/21

F.1.3 Q. If a registered representative uses visual aids, such as a whiteboard or dynamic charts, or a chat or instant messaging feature during a live, unscripted online conference, how should a firm supervise these aspects of the presentation?

A. Depending on the nature and number of persons attending the meeting, the use of these visual aids may be correspondence, retail communications or institutional communications, and the firm must supervise them as such. See FINRA Rules 2210(a), 2210(b) and 3110(b)(4). In addition, their content must be consistent with applicable standards, such as those in FINRA Rule 2210(d).

For example, if a representative meets with fewer than 25 retail investors, and uses the chat feature of the online conferencing platform to answer a live question, that chat content meets the definition of correspondence in FINRA Rule 2210(a)(2). The firm must review the chat content in the same manner as required for supervising and reviewing any other correspondence pursuant to FINRA Rule 3110(b) and 3110.06 through .09.

In another example, if during a meeting that includes more than 25 retail investors, a representative uses the chat feature to post an electronic file containing content that promotes a new mutual fund, the content in the file meets the definition of a retail communication in FINRA Rule 2210(a)(5). Because the content in the file promotes a product of the firm, a registered principal must have approved it prior to use as required by FINRA Rule 2210(b)(1)(A). In addition, because the content in the file promotes a specific registered investment company (i.e., the mutual fund), the firm must also submit it to FINRA's Advertising Regulation Department within 10 business days of first use as required by FINRA Rule 2210(c)(3). In contrast, if during an online meeting that includes more than 25 retail investors, a representative responds to a live audience question by using the platform's whiteboarding feature to draw a diagram illustrating the differences between a conventional bond and a stock, that content would meet the definition of a retail communication in FINRA Rule 2210(a)(5). However, because the representative created and posted the whiteboarding content during an online interactive electronic forum, the firm would not have to approve such content prior to use (see FINRA Rule 2210(b)(1)(D)(ii)). Instead, the firm may review the whiteboarding content in the same manner as required for supervising and reviewing correspondence pursuant to FINRA Rule 3110(b) and 3110.06 through .09.

As a final example, a representative of an ETF broker-dealer distributor hosts a webinar attended by 100 registered representatives of other broker dealers. During the presentation, the distributor representative conducts an interactive poll about the latest ETF offered by the distributor. Once the poll is complete, the distributor representative posts the results live to all of the attendees. Because the audience is composed solely of registered representatives, the poll and the results would meet the definition of institutional communication in FINRA Rule 2210(a)(3). As such, the distributor would need to review the poll and the results in accordance with the firm's written supervisory procedures for the supervision of institutional communications adopted in accordance with FINRA Rule 2210(b)(3). While such procedures don't require review of all institutional communications prior to first use, they must include provisions for the education and training of associated persons as to the firm's procedures governing institutional communications, documentation of such education and training, and surveillance and follow-up to ensure that firm personnel implement and adhere to such procedures.

Posted: 9/30/21

F.1.4 Q. If a third party, such as a fund distributor or program sponsor, presents information or speaks with clients during a presentation, either in person or using an online conferencing platform, during which a representative of a broker-dealer also speaks or presents, what must the representative disclose about that third party?

A. FINRA Rule 2210(f)(1) provides that, when participating in unscripted public appearances, associated persons of broker-dealers must follow the standards of FINRA Rule 2210(d)(1). Paragraph (d)(1)(A) requires firms' communications with the public to be fair and balanced, and prohibits the omission of material information that would cause the communication to be misleading. To comply with these obligations, when a registered representative appears at an event along with personnel from a third party, such as a fund distributor or program sponsor, the representative should clearly explain the purpose of the meeting, the identity of the third-party entity, whether the third-party entity paid for or sponsored the meeting, and the relationship between the representative, the broker-dealer, and the third-party entity. [21]

Posted: 9/30/21

F.1.5 Q. If our registered representatives use communications with the public that direct customers to in-person or online presentations hosted by a third party, what supervision requirements apply?
A. A firm is responsible under FINRA Rule 2210 for third-party content if the firm has adopted or become entangled with such content. [22]

If a firm permits its representatives to direct investors to presentations hosted by a third party that concern securities products or services, FINRA would consider the firm to have adopted that content. Accordingly, the firm would need to ensure compliance with the content and supervision standards addressed above.

In addition, even if a firm or its representatives did not direct customers to attend the third-party hosted presentation, where the firm or representative paid for, arranged for, or was otherwise involved in the presentation, FINRA would consider the firm or representative to be entangled with the presentation. Accordingly, FINRA would treat the presentation as a communication with the public by the firm. 23 Again, under such circumstances, the firm would need to ensure compliance with the content, and supervision standards addressed above.

Posted: 9/30/21

F2. Firm Name

F.2.1. Q. Is a registered representative required to disclose the firm's name during a public appearance?
A. The requirement in FINRA Rule 2210(d)(3) to disclose a firm's name applies to retail communications and correspondence. Accordingly, sales scripts, slide presentations and brochures used in connection with a public appearance must disclose the firm's name. A registered representative is not required to disclose the firm's name as part of non-scripted, extemporaneous remarks during a public appearance.

Posted: 1/7/13

G. SEC Advertising Rules

G.1. SEC Rule 482

G.1.1 Q. Does a promotional item, such as a t-shirt, cap or pen, that contains only the name of a mutual fund or fund family, have to include the prospectus offering legend required by SEC Rule 482 under the Securities Act?
A. No. In FINRA's view, promotional items that only contain the name of a mutual fund or fund family would not be considered an "advertisement" for purposes of Rule 482, and therefore, are not subject to the requirements of that rule, including the requirement to include a prospectus offering legend.

Posted: 5/22/15

G.1.2. Q. Is a communication to a customer that lists the customer's securities and other investments held at a firm, or at various broker-dealers, investment advisers and other entities, and the performance of those investments, subject to Rule 482 or Rule 34b-1 under the Investment Company Act of 1940?
A. No. In FINRA's view, assuming the communication merely informs an existing customer of his or her securities holdings and other investment positions held at the firm or at multiple intermediaries, and the prior performance of those investments, and it does not offer securities of a registered investment company, we believe that the communication would not be considered an advertisement for purposes of Rule 482 and Rule 34b-1. However, if the communication explicitly or implicitly induces the purchase of shares of a registered investment company, we believe that the communication could be subject to the requirements of Rule 482 and Rule 34b-1.

Posted: 5/22/15

---

1. See FINRA Rule 2241(a)(3), (a)(14), (h)(1), (h)(3), and (h)(5).

2. Unless FINRA specifically directs a firm to file its institutional communications pursuant to FINRA Rule 2210(c)(1)(B), a firm is not required to file its institutional communications with the Advertising Regulation Department. If a firm chooses voluntarily to file a third-party research report that qualifies as an institutional communication, however, an appropriately qualified principal must approve the report prior to filing. See FINRA Rule 2210(b)(1)(F).

3. See also letter from Afshin Atabaki, FINRA, to Wallace W. Kunzman, Jr. (December 1, 2014).

4. See FINRA Rule 2210(c)(7)(F).

5. "Responsive web design" refers to technology that changes the display of a web page in response to the needs of users and the devices they're using. The layout may change based on the size and capabilities of the device. For example, on a phone, users would see content shown in a single column view; a tablet might show the same content in two columns. See "Responsive Web Design Basics."

6. Pursuant to FINRA Rule 2210(c)(7)(B), the firm also would not be required to file future versions of the fund fact sheets (such as fact sheets issued after the end of the next calendar quarter) where the changes are limited to updates of more recent statistical or other non-narrative information and non-predictive narrative information that describes market events during the period covered by the communication or factual changes in portfolio composition or is sourced from a registered investment company's regulatory documents filed with the SEC.

7. For example, FINRA has stated that firms are not required to file information, including performance information, provided to participant-directed individual account plan participants pursuant to DOL Rule 404a-5 under ERISA. See Regulatory Notice 12-02 (January 2012).

8. See *Regulatory Notices 07-59 (FINRA Guidance Regarding Review and Supervision of Electronic Communications) and 10-06 (Guidance on Blogs and Social Networking Web Sites)* for additional guidance on supervision of digital correspondence.

9. FINRA Rule 2210(c)(7)(I) excludes from the filing requirements any reprint or excerpt of any article or report issued by a publisher, provided that (i) the publisher is not an affiliate of the member using the reprint or any underwriter or issuer of a security mentioned in the reprint that the member is promoting; (ii) neither the member using the reprint nor any underwriter or issuer of a security mentioned in the reprint has commissioned the reprinted article or report; and (iii) the member using the reprint has not materially altered its contents except as necessary to make the reprint consistent with applicable regulatory standards or to correct factual errors.

10. The SEC staff has taken the position, however, that certain interactive content posted on a real-time electronic forum (i.e., chat rooms or other social media) should be filed under the filing requirements of Section 24(b) of the Investment Company Act of 1940 or Rule 497 under the Securities Act of 1933 (Securities Act), even if it is not required to be filed with FINRA under FINRA Rule 2210. See U.S. Securities and Exchange Commission, Division of Investment Management, IM Guidance Update No. 2013-01 (March 2013).

11. See *Notice to Members 06-48* (September 2006).

12. The Hartford Letter defined "Related Performance Information" as "actual performance of all separate or private accounts or funds that have (i) substantially similar investment policies, objectives, and strategies, and (ii) are currently managed or were previously managed by the same adviser or sub-adviser that manages the registered mutual fund that is the subject of an institutional communication."

13. The Hartford Letter defined "Related Accounts" as all separate or private accounts or funds that fall within the definition of "Related Performance Information."

14. FINRA Rule 2210(d)(1)(B) states, "No member may make any false, exaggerated, unwarranted, promissory or misleading statement or claim in any communication. No member may publish, circulate or distribute any communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading."

15. The June 1997 Issue of NASD's *Regulatory and Compliance Alert* included an "Ask the Analyst" question and answer regarding banner advertisements. The answer indicated that a banner advertisement that contained a truthful claim regarding mutual funds (and that did not contain promissory language or graphics) could comply with the Rules by hyperlinking to a webpage containing the information necessary to provide a sound basis to evaluate the facts regarding the mutual funds. FINRA has extended this approach to other electronic communications such as interactive social media posts.

16. See *Regulatory Notice 17-18 (Guidance on Social Networking Websites and Business Communications)*.

17. See Investment Advisers Act Rule 206(4)-1(a)(4); see also Investment Advisers Act Release No. 5653 (December 22, 2020), 86 FR 13024 (March 5, 2021) ("Marketing Rule Adopting Release"), codified at 17 CFR 275.206(4)-1.

18. In particular, the Marketing Rule Adopting Release states that, "[s]o long as each layer of a layered advertisement complies with the requirement to provide benefits and risks in a fair and balanced manner, providing hyperlinks to additional content would meet the requirement of [the Rule]." See Marketing Rule Adopting Release, 86 FR at 13044 and note 239.

19. For details, see *Global Investment Performance Standards (GIPS) For Firms* (2020), *GIPS Standards Handbook for Firms* (2020) and *FINRA Regulatory Notice 20-21 and the GIPS Standards* (video).

20. For specific details on the requirements of this limited exception, see Memorandum RE: FINRA's Regulatory Notice 20-21 and References to the GIPS Standards.

21. See *Regulatory Notice 07-43 (Senior Investors)* and *Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars* for a discussion of effective practices regarding sales seminars.

22. See, e.g., *Regulatory Notice 17-18 (Guidance on Social Networking Websites and Business Communications)*.

23. See *Regulatory Notice 10-06 (Guidance on Blogs and Social Networking Web Sites)* for a discussion of the "adoption" and "entanglement" theories as they apply to third-party content.

^ Back to top


What and When to File

Definitions

1. What are the categories that make up communications with the public?

FINRA Rule 2210 defines three categories of communications:

- **Retail communication** consists of any written (including electronic) communication that is distributed or made available to **more than 25 retail investors within any 30 calendar-day period**. A retail investor is any person other than an institutional investor, regardless of whether the person has an account with the firm.
- **Correspondence** consists of any written (including electronic) communication distributed or made available to **25 or fewer retail investors within any 30 calendar-day period**.
- **Institutional communication** means any written (including electronic) communication that is distributed or made available only to institutional investors as defined but does not include a firm's internal communications. Institutional investors include banks, savings and loan associations, insurance companies, registered investment companies, registered investment advisors, a person or entity with assets of at least $50 million, government entities, employee benefit plans and qualified plans with at least 100 participants, FINRA member firms and registered persons, and a person acting solely on behalf of an institutional investor.

  If a firm has reason to believe that a communication intended for institutional investors will be forwarded to or made available to a person that is not an institutional investor, the communication must not be treated as an institutional communication. Note that individual participants of employee benefit plans and qualified plans are not considered institutional investors.

Internal Approval

^ Back to top

1. What are the approval requirements for retail communications?

FINRA Rule 2210(b) requires that all retail communications must be approved by an appropriately qualified registered principal before the earlier of its use or filing with FINRA's Advertising Regulation Department.

2. Are there any exceptions to the principal approval requirement for retail communications?

A registered principal does not need to approve any retail communication that has already been filed with FINRA and that FINRA has deemed consistent with applicable standards, provided the communication has not been materially altered.

In addition, prior to use, approval is not required if a firm supervises and reviews the following types of retail communications in the same manner as correspondence pursuant to FINRA Rule 3110(b) and 3110 Supplementary Material .06 through .09:

- any retail communication that does not make any financial or investment recommendation or otherwise promote a product or service of the member.
- any retail communication that is posted on an online interactive electronic forum.
- Any retail communication that is excepted from the definition of "research report" pursuant to FINRA Rule 2241(a)(11(A) and 2242(a)(3)(A).

Filing Requirements

^ Back to top

1. What communications must be filed with FINRA prior to use?

The following retail communications must be filed at least 10 business days prior to first use or publication:

- retail communications of new member firms used in any electronic or public media for one year beginning on the date the firm's FINRA membership becomes effective, as reflected in the CRD system. For example, this requirement applies to any generally accessible website; newspaper, magazine, telephone directory or other advertisements; television or radio commercials; telephone or audio recordings; video displays, signs or billboards; and motion pictures;

- retail communications that include rankings or performance comparison information that is not generally published or that is created by the investment company;
- security futures retail communications; and
- retail communications concerning options used prior to delivery of the options disclosure document must be filed 10 **calendar** days prior to use.

2. What communications must be filed with FINRA *within 10 business days?*

The following retail communications must be filed within 10 business days of use:

- registered investment company retail communications that promote or recommend a specific registered investment company or family of registered investment companies;
- retail communications concerning any structured or derivative product registered under the Securities Act;
- retail communications concerning public direct participation programs;
- retail communications concerning collateralized mortgage obligations registered under the Securities Act;
- final filmed versions of television and video communications previously filed in draft form.

See "What and When to File with Advertising Regulation."

3. What communications do not need to be filed with FINRA?

The filing requirements do not apply to institutional communications and correspondence.

4. Must all retail communications be filed with FINRA?

No, some retail communications are excluded from the filing requirements. However, it is important to note that whether a communication is subject to filing or not, firms must ensure that all their communications regarding financial products and services comply with applicable FINRA, SEC, MSRB and SIPC rules.

The following retail communications are excluded from the filing requirements:

- communications that refer to types of investments solely as a listing of the products or services offered by the firm;
- retail communications that do not make any financial or investment recommendation or promote a product or service of the firm;
- prospectuses, preliminary prospectuses, fund profiles, offering circulars, annual and semi-annual reports and similar documents filed with the SEC or any state in compliance with applicable requirements as well as offering documents concerning securities exempt from such filing or registration including free writing prospectuses exempt from filing with the SEC. Note: When reviewing a filed communication, FINRA staff may request, or members may provide the relevant product prospectus;
- previously-filed retail communications that are used without material change;
- retail communications based on previously filed templates, with changes limited to updates of more recent statistical or other non-narrative information and non-predictive narrative information that describes market events during the periods covered by the communication or sourced from the investment company's regulatory documents filed with the SEC;
- retail communications posted on an online interactive electronic forum;
- press releases issued by NYSE-listed, closed-end investment companies as required by section 202.06 of the NYSE Listed Company Manual;
- retail communications subject to SEC Rule 134 and matter of record announcements regarding participation in a private placement (except for those related to public DPPs or registered investment company securities);
- press releases made available only to the members of the media;
- any reprint or excerpt of an article issued by a publisher that has not been materially altered in content except to comply with regulatory standards or correct errors and when the member has not commissioned the reprint and is not affiliated with the publisher; and
- retail communications that do no more than identify the member or offer a specific security at a stated price.

5. Can communications be filed voluntarily?

Yes, firms may voluntarily file communications for review by FINRA. Some reasons for filing voluntarily include:

- new product launch;
- use of a new format or medium, such as the firm's first television commercial or the firm's first mobile application;
- address compliance questions; and
- rule changes.

6. What information should accompany filings of ghostwritten communications on behalf of third party vendors?

FINRA understands that some firms file ghostwritten communications on behalf of third party vendors for review. In order to facilitate these reviews, firms should disclose to FINRA that the communications were created by a third party vendor which may market them to other firms. Firms are reminded that Regulatory Notice 08-27 provides guidance about the use of ghostwritten communications.

^ Back to top

How to File

1. How do I file communications for review by FINRA?
Firms file most communications for review using the Advertising Regulation Electronic Files (AREF) system. You may also call the Advertising Regulation Department at (240) 386-4500 to learn more about how to file using AREF.

2. How will FINRA respond to communications that firms submit for review?
FINRA provides a written "Review Letter" electronically via the AREF system. The Review Letter provides necessary comments as to the compliance of the submission. In addition, the review letter documents the cost of the review.

Our expedited review service provides for a response within three business days (or other negotiated time period) after the day FINRA receives the material. FINRA will send expedited responses no later than close of business on the third review day. However, response time for regular submissions may vary depending on the volume of filings FINRA receives.

3. What are the filing fees for the submission of communications to FINRA?
As set forth in Section 13, Schedule A of the FINRA By-laws, the following fees apply to each communication submitted:

Regular Filings:

- $ 125.00 for the first ten pages of material
- $ 10.00 for each additional page
- $ 125.00 for the first ten minutes of each video and audio item
- $ 10.00 for each additional minute of each video and audio item

Expedited Filings:

- $600.00 for all requests for expedited review for the first ten pages/minutes
- $ 50.00 per page/minute in excess of the first ten pages/minutes

4. How are filing fees paid?
Each month, your firm's Super Account Administrator will receive an email notification that an Advertising Regulation invoice is available in E-Bill via FINRA Gateway. The Advertising Regulation Invoice will provide detailed transaction charges incurred during the billing period along with the total amount due. You may pay your Advertising Regulation fling fees online using E-Bill:

A. Firm Bank Account (ACH payment)
B. Credit Card Payment (Visa, MasterCard or American Express)

In addition, there are three other payment methods

A. **FINRA Flex-Funding Account**

The FINRA Flex-Funding Account, formerly known as the CRD/IARD Daily Account, allows firms to view invoices and pay fees formerly paid through the Web CRD system.

B. **Wire Payments**

Funds may be wired for payment of filing fees. To pay Advertising invoices by wire transfers, provide your bank with the following information:

Bank Name: Bank of America
Transfer funds to: FINRA
Wire ABA Number: 026009593
ACH ABA Number: 054001204
Beneficiary: FINRA

Invoice Number

C. **Check Payment**

Checks can be sent by regular mail or by courier/overnight delivery. Checks sent by regular mail must be sent to the P.O. Box address provided below. All checks sent by courier or overnight delivery **must** be sent to the alternative address provided below, as the P.O. Box address **will not** accept courier or overnight deliveries. We encourage the use of the P.O. Box address as it facilitates more timely automated processing of your remittance.

Include the invoice number on the check and send the payment to:

FINRA
P.O. Box 418911
Boston, MA 02241-8911

(Note: P.O. Box does not accept overnight/courier deliveries)

For courier/overnight CHECKS only:

Bank of America Lockbox Services
FINRA 418911
MA5-527-02-07
2 Morrissey Blvd.
Dorchester, MA 02125

Please contact the Finance billing department with questions about your Advertising Regulation Invoice at (240) 386-5397.

5. How do I access additional information about my Advertising Regulation fee transactions?
Firms may view online in AREF a real time listing of current and past transactions. If your firm incurred filing fees prior to December 2012, you may also view historical Advertising Regulation Fee Account statements.

6. How do I contact the Department?
Our contact information is:

FINRA
Advertising Regulation Department
9509 Key West Avenue
Rockville, MD 20850-3389

Telephone: (240) 386-4500
Fax: (240) 386-4568
FINRA_ADV@FINRA.org

Regulatory Notice 11-39

Social Media Websites and the Use of Personal Devices for Business Communications

Guidance on Social Networking Websites and Business Communications

Executive Summary

In January 2010, FINRA issued *Regulatory Notice 10-06*, providing guidance on the application of FINRA rules governing communications with the public to social media sites and reminding firms of the recordkeeping, suitability, supervision and content requirements for such communications. Since its publication, firms have raised additional questions regarding the application of the rules. This *Notice* responds to these questions by providing further clarification concerning application of the rules to new technologies. It is not intended to alter the principles or the guidance provided in *Regulatory Notice 10-06*.

Questions concerning this *Notice* may be directed to:

- Joseph E. Price, Senior Vice President, Advertising Regulation/Corporate Financing, at (240) 386-4623;
- Thomas A. Pappas, Vice President, Advertising Regulation, at (240) 386-4553; or
- Amy Sochard, Director, Advertising Regulation, at (240) 386-4508.

August 2011

Notice type:
- Guidance

Suggested Routing
- Advertising
- Compliance
- Legal
- Operations
- Registered Representative
- Senior Management

Key Topics
- Communications With the Public
- Personal Electronic Devices
- Recordkeeping
- Social Networking Websites
- Supervision

Referenced Rules & Notices
- NASD Rule 2210
- NASD Rule 2211
- NASD Rule 3010
- FINRA Rule 4511
- NTM 05-48
- Regulatory Notice 08-77
- Regulatory Notice 10-06
- Regulatory Notice 11-14
- SEA Rule 17a-3
- SEA Rule 17a-4

FINRA
Financial Industry Regulatory Authority

Background

1. Recordkeeping

The obligations of a firm to keep records of communications made through social media depend on whether the content of the communication constitutes a business communication. Rule 17a-4(b) under the Securities Exchange Act of 1934 (SEA) requires broker-dealers to preserve certain records for a period of not less than three years, the first two in an easily accessible place.[1] Among these records, pursuant to SEA Rule 17a-4(b)(4), are "[o]riginals of all communications received and copies of all communications sent (and any approvals thereof) by the member, broker or dealer (including inter-office memoranda and communications) relating to its business as such, including all communications which are subject to rules of a self-regulatory organization of which the member, broker or dealer is a member regarding communications with the public."[2] The SEC has stated that the content of an electronic communication determines whether it must be preserved.[3]

2. Supervision

NASD Rule 3010 requires each firm to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable federal securities laws and FINRA rules. As part of this responsibility, a registered principal must review prior to use any social media site that an associated person intends to employ for a business purpose. The registered principal may approve use of the site for a business purpose only if the registered principal has determined that the associated person can and will comply with all applicable FINRA rules, the federal securities laws, including recordkeeping requirements, and any additional requirements established by the firm.

The registered principal must review an associated person's proposed social media site in the form in which it will be "launched." Some firms require a registered principal to review the first posting by an associated person on an interactive forum within the site. This approach can help to ensure that the registered principal will be reviewing not only the initial communication, but the social media site itself in its completed design.

FINRA considers unscripted participation in an interactive electronic forum to come within the definition of "public appearance" under NASD Rule 2210. Public appearances do not require prior approval by a registered principal. Firms may adopt risk-based supervisory procedures utilizing post-use review, including sampling and lexicon-based search methodologies, of unscripted participation in an interactive electronic forum. The procedures a firm adopts must be reasonably designed to ensure that interactive electronic communications do not violate FINRA or SEC rules, including the content requirements of NASD Rule 2210, such as the prohibition on misleading statements or claims and the requirement that communications be fair and balanced. A static posting is deemed an "advertisement" under NASD Rule 2210 and therefore requires a registered principal to approve the posting prior to use.[4]

3. Links to Third-Party Sites

Firms may not establish a link to any third-party site that the firm knows or has reason to know contains false or misleading content. A firm should not include a link on its website if there are any red flags that indicate the linked site contains false or misleading content. Additionally, a firm is responsible under NASD Rule 2210 for content on a linked third-party site if the firm has adopted or has become entangled with its content. For example, a firm may be deemed to have "adopted" third-party content if it indicates on its site that it endorses the content on the third-party site. A firm could be deemed to have become "entangled" with a third-party site if, for example, it participates in the development of the content on the third-party site.

4. Data Feeds

Firms must adopt procedures to manage data feeds into their own websites. FINRA is aware of situations in which firms have received data feeds that were inaccurate. Firms must be familiar with the proficiency of the vendor of the data and its ability to provide data that is accurate as of the time it is presented on the firm's website. Firms also must understand the criteria followed by vendors in gathering or calculating the types of data that the firm intends to feed into its website, in order to determine whether the vendor is performing this function in a reasonable manner.[5] Firms also should regularly review aspects of these data feeds for any red flags that indicate that the data may not be accurate, and should promptly take necessary measures to correct any inaccurate data.

Questions & Answers

Recordkeeping

Q1: Does determining whether a communication is subject to the recordkeeping requirements of SEA Rule 17a-4(b)(4) depend on whether an associated person uses a personal device or technology to make the communication?

A1: SEA Rule 17a-4(b)(4) requires a firm to retain records of communications that relate to its "business as such." Whether a particular communication is related to the business of the firm depends upon the facts and circumstances. This analysis does not depend upon the type of device or technology used to transmit the communication, nor does it depend upon whether it is a firm-issued or personal device of the individual; rather, the content of the communication is determinative. For instance, the requirement would apply if the electronic communication was received or sent by an associated person through a third-party's platform or system. A firm's policies and procedures must include training and education of its associated persons regarding the differences between business and non-business communications and the measures required to ensure that any business communication made by associated persons is retained, retrievable and supervised.

Q2: When an associated person posts autobiographical information, such as place of employment or job responsibilities, does this information constitute a business communication?

A2: As discussed in question 1 above, firms must develop policies and procedures that include training regarding the difference between business and non-business communications to enable appropriate compliance. In certain contexts, such as sending a resume to a potential employer, the communication could be viewed as not relevant to the business of the firm. In other contexts, such as posting a list of products or services offered by the firm, the communication likely will be viewed as a business communication.

Q3: May a firm or associated person sponsor a social media site or use a communication device that includes technology which automatically erases or deletes the content?

A3: No. Technology that automatically erases or deletes the content of an electronic communication would preclude the ability of the firm to retain the communications in compliance with their obligations under SEA Rule 17a-4. Accordingly, firms and associated persons may not sponsor such sites or use such devices.

Q4: Do the recordkeeping requirements apply to third-party posts to a firm or an associated person's social media sites if the firm or the individual has not adopted or become entangled with the post?

A4: *Regulatory Notice 10-06* addresses the application of NASD Rule 2210 to third-party posts on a social media site established by a firm or its associated persons. Unless the firm or its associated persons have adopted or become entangled with the post, FINRA generally does not treat third-party posts as the firm's or its associated persons' communications under the rule. The recordkeeping requirements, however, require retention of the records of all communications received by a firm or its associated persons relating to its business as such.

Q5: Do the recordkeeping requirements differ for static and interactive communications?

A5: They do not—the recordkeeping requirements are governed by the content of the communication. As noted above, the FINRA *supervision* requirements differ for static and interactive communications.

Supervision

Q6: Can interactive content become static?

A6: Yes. For example, interactive content could be copied or forwarded and posted in a static forum, such as a blog or static area of a Web page, in a manner that renders it static content. It then would constitute an advertisment under NASD Rule 2210, requiring prior approval by a registered principal of the firm.

Q7: What measures should a firm adopt to monitor compliance with its social media policies?

A7: A firm must conduct appropriate training and education concerning its policies, including those relating to social media. Firms must follow up on "red flags" that may indicate that an associated person is not complying with firm policies. Some firms require each associated person to certify on an annual or more frequent basis that the associated person is acting in a manner consistent with such policies. When feasible, some firms also have chosen to randomly spot check websites to help them monitor compliance with firm policies.

Q8: Must material changes to static content posted by a firm or its associated persons on a social media site that contains business communications receive prior approval by a registered principal?

A8: NASD Rule 2210(1)(b) requires a registered principal to approve each advertisement and item of sales literature before the earlier of its use or filing with FINRA's Advertising Regulation Department. NASD Rule 2210(c)(8) excludes from the filing requirements any advertisement or sales literature that previously had been filed and that is to be used "without material change." Firms are expected to adopt procedures requiring prior registered principal approval of any advertisement or sales literature that has been materially changed, even if it had been previously approved in an earlier version. For example, changes in the description of the advantages of investing in the advertised product or of its risks would typically require registered principal prior approval. Since static content posted by a firm or its associated persons on a social media site that contains business communications is considered to be an advertisement, these procedures must apply to such static content.

Third-Party Posts, Third-Party Links and Websites

Q9: If a third party posts a business-related communication, such as a question about a security, on an associated person's personal social media site, may the associated person respond to the communication?

A9: Yes, provided that the response does not violate the firm's policies concerning participation on a personal social media site. If a firm has a policy that associated persons may not use a personal social media site for business purposes, then a substantive response by the associated person would violate this policy.[6] Some firms permit a non-substantive response, and pre-approve statements that their associated persons may make to respond to such posts and that direct the third party to other firm-approved communication media, such as the firm's email system.

Q10: To what extent is a firm responsible for any third-party website that the firm or its associated person "co-brands"?

A10: Under NASD Rule 2210, a firm that co-brands any part of a third-party site, such as by placing the firm's logo prominently on the site, is responsible for the content of the entire site. Under these circumstances, FINRA considers the firm to have adopted the content on that site. A firm is responsible under NASD Rule 2210 for content on a linked third-party site if the firm has adopted or become entangled with its content. *Regulatory Notice 10-06* describes the "adoption" and "entanglement" theories as they apply to third-party posts on a firm's social media sites. FINRA considers a firm to have adopted content in a third-party post if the firm or its personnel explicitly or implicitly endorse or approve the post.

Q11: When is a firm *not* responsible for the content on a third-party site to which it links?

A11: A firm may establish a link to the site of an independent third party without assuming responsibility for the content of that site under NASD Rule 2210 if:

- the firm does not "adopt" or become "entangled" with the content of the third-party site; and
- the firm does not know or have reason to know that the site contains false or misleading information.

Q12: If firm policy requires deletion of inappropriate third-party content, will the firm be considered to have adopted any third-party posts that are not deleted?

A12: No. The fact that the firm has a policy of routinely blocking or deleting certain types of content in order to ensure the content is appropriate would not mean that the firm had adopted the content of the posts left on the site. For example, most firms using social media sites block or screen offensive material. Such a policy would not indicate that the firm has adopted the remaining third-party content.

Q13: Does NASD Rule 2210 require firms to approve or maintain records of statistical information that the firm has regularly updated on its website?

A13: NASD Rule 2210(b)(1) requires that a registered principal approve each advertisement and item of sales literature prior to use or filing with FINRA's Advertising Regulation Department. NASD Rule 2210(b)(2) requires firms to maintain all advertisements and sales literature, including the names of the persons who prepared them or approved their use, for a period beginning on the date of first use and ending three years from the date of last use.

Statistical information that is posted on a firm's website would be considered an "advertisement" subject to the approval and recordkeeping requirements of NASD Rules 2210(b)(1) and (2). However, some firms establish templates for the presentation of this data, and subject these templates to those provisions. The data that is fed into the website in accordance with such a template would not be subject to the requirements of NASD Rules 2210(b)(1) and (2). The firm must have procedures reasonably designed to ensure that the data can be verified to ensure that it is timely and accurate, and that the firm can promptly correct data that is erroneous when posted or becomes inaccurate over time.

Accessing Social Media Sites From Personal Devices

Q14: May associated persons use personal communication devices and other equipment, such as a smart phone or tablet computer, to access firm business applications and perform business activity if the firm employs technology that enables the firm to keep records and supervise the activity?

A14: Yes. Firms may permit their associated persons to use any personal communication device, whether it is owned by the associated person or the firm, for business communications. FINRA recognizes that the development of new technologies can facilitate the ability of associated persons to perform their responsibilties and, in the case of registered representatives, to serve their clients. Of course, the firm must be able to retain, retrieve and supervise business communications regardless of whether they are conducted from a device owned by the firm or by the associated person.

In order to ensure that the business communications are readily retrievable without necessitating the capture of personal communications made on the same device, firms should have the ability to separate business and personal communications, such as by requiring that the associated persons use a separately identifiable application on the device for their business communications. If possible, this application should provide a secure portal into the firm's own communication system, particularly if confidential customer information may be shared. If the firm has the ability to separate business and personal communications, and has adequate electronic communications policies and procedures regarding usage, then the firm is not required to supervise the personal emails made on these devices. Of course, firms also are free to treat all communications made through the personal communication device as business communications.

Endnotes

1. SEA Rule 17a-4(f) permits broker-dealers to maintain and preserve these records on "micrographic media" or by means of "electronic storage media," as defined in the rule and subject to a number of conditions.

2. *See also* NASD Rule 2210(b)(2) (requiring the retention of all advertisements, sales literature and independently prepared reprints), NASD Rule 2211(b)(2) (requiring the retention of institutional sales material) and NASD Rule 3010(d)(3) (requiring the retention of correspondence of registered representatives).

3. *See* Reporting Requirements for Brokers or Dealers under the Securities Exchange Act of 1934, SEC Rel. No. 34-38245 (Feb. 5, 1997).

4. FINRA has filed with the SEC a proposed rule change that would replace most of the NASD and NYSE rules governing communications with the public with a series of new FINRA rules. *See* SR-FINRA-2011-035. Among other changes, the term "advertisement" would be subsumed within a new communication category, "retail communication."

5. *Cf.*, *Regulatory Notice 08-77* (Dec. 2008) (Customer Account Statements) (discussion of "data vendors"). *See also Notice to Members (NTM) 05-48* (July 2005) (Members' Responsibilities When Outsourcing Activities to Third-Party Service Providers); *Regulatory Notice 11-14* (March 2011) (FINRA Requests Comment on Proposed New FINRA Rule 3190 to Clarify the Scope of a Firm's Obligations and Supervisory Responsibilities for Functions or Activities Outsourced to a Third-Party Service Provider).

6. Of course, if the firm permits business-related communications on a personal social media site, then the firm must supervise that site for compliance with applicable rules and the federal securities laws.

Regulatory Notice 10-06

Social Media Web Sites

Guidance on Blogs and Social Networking Web Sites

Executive Summary

Americans are increasingly using social media Web sites, such as blogs and social networking sites, for business and personal communications. Firms have asked FINRA staff how the FINRA rules governing communications with the public apply to social media sites that are sponsored by a firm or its registered representatives. This *Notice* provides guidance to firms regarding these issues.

Questions concerning this *Notice* may be directed to:

- Joseph E. Price, Senior Vice President, Advertising Regulation/ Corporate Financing, at (240) 386-4623; or
- Thomas A. Pappas, Vice President and Director, Advertising Regulation, at (240) 386-4500.

Background

According to a recent report by the Pew Internet and American Life Project, 46 percent of American adults who use the Internet logged onto a social networking site in 2009, which is up from 8 percent in 2005.[1] Other studies have shown that use of social media sites by businesses to communicate with customers and the public has grown significantly in the past few years.[2]

FINRA has provided guidance concerning particular applications of the communications rules to interactive Web sites in the past. For example, in March 1999, FINRA stated that a registered representative's participation in an Internet chat room is subject to the same requirements as a presentation in person before a group of investors.[3] This guidance was codified in 2003, when FINRA defined the term "public appearance" in NASD Rule 2210 to include participation in an interactive electronic forum.[4]

January 2010

Notice Type

- Guidance

Suggested Routing

- Advertising
- Compliance
- Legal
- Operations
- Registered Representative
- Senior Management

Key Topics

- Blogs
- Communications with the Public
- Recordkeeping
- Social Networking Web Sites
- Supervision

Referenced Rules & Notices

- ICA Section 24(b)
- NASD Rule 2210
- NASD Rule 2310
- NASD Rule 2711
- NASD Rule 3010
- NASD Rule 3070
- NASD Rule 3110
- NYSE Rule 351
- NYSE Rule 401A
- NYSE Rule 410
- NYSE Rule 472
- NTM 01-23
- NTM 03-33
- Regulatory Notice 07-59
- Regulatory Notice 09-55
- SEA Rule 17a-3
- SEA Rule 17a-4
- Securities Act Rule 482

FINRA
Financial Industry Regulatory Authority

FINRA also has provided guidance regarding the application of the communication rules in its *Guide to the Internet for Registered Representatives*,[5] and has released podcasts on these issues to help educate firms and their personnel.[6] Nevertheless, FINRA staff has continued to receive numerous inquiries from firms and others concerning how the FINRA rules governing communications with the public apply to the use of social media sites by firms and their registered representatives. Firms also have inquired regarding their recordkeeping responsibilities for communications posted on social media sites.

In September 2009, FINRA organized a Social Networking Task Force composed of FINRA staff and industry representatives to discuss how firms and their registered representatives could use social media sites for legitimate business purposes in a manner that ensures investor protection. Based on input from the Task Force and others, and further staff consideration of these issues, FINRA is issuing this *Notice* to guide firms on applying the communications rules to social media sites, such as blogs and social networking sites. The goal of this *Notice* is to ensure that—as the use of social media sites increases over time—investors are protected from false or misleading claims and representations, and firms are able to effectively and appropriately supervise their associated persons' participation in these sites. At the same time, FINRA is seeking to interpret its rules in a flexible manner to allow firms to communicate with clients and investors using this new technology.

While many firms may find that the guidance in this *Notice* is useful when establishing their own procedures, each firm must develop policies and procedures that are best designed to ensure that the firm and its personnel comply with all applicable requirements. Every firm should consider the guidance provided by this *Notice* in the context of its own business and its compliance and supervisory programs.

This *Notice* only addresses the use by a firm or its personnel of social media sites for business purposes. The *Notice* does not purport to address the use by individuals of social media sites for purely personal reasons.

Questions & Answers

Recordkeeping Responsibilities

Q1: Are firms required to retain records of communications related to the broker-dealer's business that are made through social media sites?

A1: Yes. Every firm that intends to communicate, or permit its associated persons to communicate, through social media sites must first ensure that it can retain records of those communications as required by Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 and NASD Rule 3110. SEC and FINRA rules require that for record retention purposes, the content of the communication is determinative and a broker-dealer must retain those electronic communications that relate to its "business as such."[7]

FINRA is aware that some technology providers are developing systems that are intended to enable firms to retain records of communications made through social media sites. Some systems might interface with a firm's network to capture social media participation and feed it into existing systems for the review and retention of email. Other providers are developing technology that might permit a registered representative working off-site to elect to access social media through platforms that will retain the communications on behalf of the firm.

Of course, it is up to each firm to determine whether any particular technology, system or program provides the retention and retrieval functions necessary to comply with the books and records rules. FINRA does not endorse any particular technology necessary to keep such records, nor is it certain that adequate technology currently exists.

Suitability Responsibilities

Q2: If a firm or its personnel recommends a security through a social media site, does this trigger the requirements of NASD Rule 2310 regarding suitability?

A2: Yes. Whether a particular communication constitutes a "recommendation" for purposes of Rule 2310 will depend on the facts and circumstances of the communication. Firms should consult *Notice to Members (NTM) 01-23* (Online Suitability) for additional guidance concerning when an online communication falls within the definition of "recommendation" under Rule 2310.

Various social media sites include functions that make their content widely available or that limit access to one or more individuals. Rule 2310 requires a broker-dealer to determine that a recommendation is suitable for every investor to whom it is made.

Q3: What factors should firms consider when developing procedures for supervising interactive electronic communications on a social media site that recommend specific investment products?

A3: Communications that recommend specific investment products often present greater challenges for a firm's compliance program than other communications. As discussed above, they may trigger the FINRA suitability rule, thus creating possible substantive liability for the firm or a registered representative. These communications must often include additional disclosure in order to provide the customer with a sound basis for evaluating the facts with respect to the product. They also might trigger other requirements under the federal securities laws.[8] FINRA has brought disciplinary actions regarding interactive electronic communications that contained misleading statements about investment products that the communications recommended.[9]

For these reasons, firms must adopt policies and procedures reasonably designed to address communications that recommend specific investment products. As a best practice, firms should consider prohibiting all interactive electronic communications that recommend a specific investment product and any link to such a recommendation unless a registered principal has previously approved the content.

Alternatively, many firms maintain databases of previously approved communications and provide their personnel with routine access to these templates. Firms might consider prohibiting communications that recommend a specific investment product unless the communication conforms to a pre-approved template and the specific recommendation has been approved by a registered principal. Firms also should consider adopting policies and procedures governing communications that promote specific investment products, even if these communications might not constitute a "recommendation" for purposes of our suitability rule or otherwise.

Types of Interactive Electronic Forums

The definition of "public appearance" in NASD Rule 2210 includes unscripted participation in an interactive electronic forum such as a chat room or online seminar. Rule 2210 does not require firms to have a registered principal approve in advance the extemporaneous remarks of personnel who participate in public appearances. However, these interactive electronic forums are subject to other supervisory requirements and to the content requirements of FINRA's communications rule.

Q4: Does a blog constitute an "interactive electronic forum" for purposes of Rule 2210?

A4: The treatment of a blog under Rule 2210 depends on the manner and purposes for which the blog has been constructed. Merriam-Webster's Online Dictionary defines "blog" as "a Web site that contains an online personal journal with reflections, comments, and often hyperlinks provided by the writer."[10] Historically, some blogs have consisted of static content posted by the blogger. FINRA considers static postings to constitute "advertisements" under Rule 2210. If a firm or its registered representative sponsors such a blog, it must obtain prior principal approval of any such posting. Today, however, many blogs enable users to engage in real-time interactive communications. If the blog is used to engage in real-time interactive communications, FINRA would consider the blog to be an interactive electronic forum that does not require prior principal approval; however, such communications must be supervised, as discussed below.[11]

Q5: Social networking sites, such as Facebook, Twitter and LinkedIn, typically include both static content and interactive functions. Are these sites interactive electronic forums for purposes of Rule 2210?

A5: Social networking sites typically contain both static and interactive content. The static content remains posted until it is changed by the firm or individual who established the account on the site. Generally, static content is accessible to all visitors to the site.

Examples of static content typically available through social networking sites include profile, background or wall information. As with other Web-based communications such as banner advertisements, a registered principal of the firm must approve all static content on a page of a social networking site established by the firm or a registered representative before it is posted.[12] Firms may use an electronic system to document these approvals.

Social networking sites also contain non-static, real-time communications, such as interactive posts on sites such as Twitter and Facebook. The portion of a social networking site that provides for these interactive communications constitutes an interactive electronic forum, and firms are not required to have a registered principal approve these communications prior to use. Of course, firms still must supervise these communications, as discussed below.

Supervision of Social Media Sites

Q6: How must firms supervise interactive electronic communications by the firm or its registered representatives using blogs or social networking sites?

A6: The content provisions of FINRA's communications rules apply to interactive electronic communications that the firm or its personnel send through a social media site. While prior principal approval is not required under Rule 2210 for interactive electronic forums, firms must supervise these interactive electronic communications under NASD Rule 3010 in a manner reasonably designed to ensure that they do not violate the content requirements of FINRA's communications rules.[13]

Firms may adopt supervisory procedures similar to those outlined for electronic correspondence in *Regulatory Notice 07-59* (FINRA Guidance Regarding Review and Supervision of Electronic Communications). As set forth in that *Notice*, firms may employ risk-based principles to determine the extent to which the review of incoming, outgoing and internal electronic communications is necessary for the proper supervision of their business.

For example, firms may adopt procedures that require principal review of some or all interactive electronic communications prior to use or may adopt various methods of post-use review, including sampling and lexicon-based search methodologies as discussed in *Regulatory Notice 07-59*. We are aware that technology providers are developing or may have developed systems that are intended to address both the books and records rules and supervisory procedures for social media sites that are similar or equivalent to those currently in use for emails and other electronic communications. FINRA does not endorse any particular technology. Whatever procedures firms adopt, however, must be reasonably designed to ensure that interactive electronic communications do not violate FINRA or SEC rules.

Firms are also reminded that they must have policies and procedures, as described in *Regulatory Notice 07-59*, for the review by a supervisor of employees' incoming, outgoing and internal electronic communications that are of a specific subject matter that require review under FINRA rules and federal securities laws, including:

- NASD Rule 2711(b)(3)(A) and NYSE Rule 472(b)(3), which require that a firm's legal and compliance department be copied on communications between non-research and research departments concerning the content of a research report;
- NASD Rule 3070(c) and NYSE Rule 351(d), which require the identification and reporting of customer complaints; NYSE Rule 401A requires that the receipt of each complaint be acknowledged by the firm to the customer within 15 business days; and

- NASD Rule 3110(j) and NYSE Rule 410, which require the identification and prior written approval of every order error and other account designation change.

Q7: What restrictions should firms place on which personnel may establish an account with a social media site?

A7: Firms must adopt policies and procedures reasonably designed to ensure that their associated persons who participate in social media sites for business purposes are appropriately supervised, have the necessary training and background to engage in such activities, and do not present undue risks to investors. Firms must have a general policy prohibiting any associated person from engaging in business communications in a social media site that is not subject to the firm's supervision. Firms also must require that only those associated persons who have received appropriate training on the firm's policies and procedures regarding interactive electronic communications may engage in such communications.

As firms develop their policies, they should consider prohibiting or placing restrictions on any associated person who has presented compliance risks in the past, particularly compliance risks concerning sales practices, from establishing accounts for business purposes with a social media site. In its supervision of social networking sites, each firm must monitor the extent to which associated persons are complying with the firm's policies and procedures governing the use of these sites. Firms also should consider policies that address associated persons' continued use of such sites if the firm's supervisory systems demonstrate compliance risks. Firms should take disciplinary action if the firm's policies are violated.

Third-Party Posts

Q8: If a customer or other third party posts content on a social media site established by the firm or its personnel, does FINRA consider the third-party content to be the firm's communication with the public under Rule 2210?

A8: As a general matter, FINRA does not treat posts by customers or other third parties as the firm's communication with the public subject to Rule 2210. Thus, the prior principal approval, content and filing requirements of Rule 2210 do not apply to these posts.

Under certain circumstances, however, third-party posts may become attributable to the firm. Whether third-party content is attributable to a firm depends on whether the firm has (1) involved itself in the preparation of the content or (2) explicitly or implicitly endorsed or approved the content.

The SEC has referred to circumstance (1) above as the "entanglement" theory (*i.e.,* the firm or its personnel is entangled with the preparation of the third-party post) and (2) as the "adoption" theory (*i.e.,* the firm or its personnel has adopted its content).[14] Although the SEC has employed these theories as a basis for a company's responsibility for third-party information that is hyperlinked to its Web site, a similar analysis would apply to third-party posts on a social media site established by the firm or its personnel.

For example, FINRA would consider such a third-party post to be a communication with the public by the firm or its personnel under the entanglement theory if the firm or its personnel paid for or otherwise was involved with the preparation of the content prior to posting. FINRA also would consider a third-party post to be a communication with the public by the firm or its personnel under the adoption theory if, after the content is posted, the firm or its personnel explicitly or implicitly endorses or approves the post.[15]

Q9: Must a firm also use a disclaimer to inform customers that third-party posts do not reflect the views of the firm and have not been reviewed by the firm for completeness or accuracy?

A9: Assuming the disclaimer was sufficiently prominent to inform investors of the firm's position, such a disclaimer would be part of the facts and circumstances that FINRA would consider in an analysis of whether a firm had adopted or become entangled with a posting.

Q10: Must a firm monitor third-party posts?

A10: FINRA does not consider a third-party post to be a firm communication with the public unless the firm or its personnel either is entangled with the preparation of the third-party post or has adopted its content. Nevertheless, FINRA has found through its discussions with members of the Social Networking Task Force and others that many firms monitor third-party posts on firm Web sites. For example, some firms monitor third-party posts to mitigate the perception that the firm is adopting a third-party post, to address copyright issues or to assist compliance with the "Good Samaritan" safe harbor for blocking and screening offensive material under the Communications Decency Act.[16]

Some of the other best practices adopted by Task Force members include:

- establishing appropriate usage guidelines for customers and other third parties that are permitted to post on firm-sponsored Web sites;
- establishing processes for screening third-party content based on the expected usage and frequency of third-party posts; and
- disclosing firm policies regarding its responsibility for third-party posts.

Endnotes

1 *See* Amanda Lenhart, Pew Internet and American Life Project, *The Democratization of Online Social Networks* (Oct. 8, 2009), *http://fe01.pewinternet.org/Presentations/2009/41--The-Democratization-of-Online-Social-Networks.aspx*.

2 Sharon Gaudin, *Business Use of Facebook, Twitter Exploding*, Computerworld (Nov. 9, 2009), at *www.computerworld.com/s/article/9140579/Business_use_of_Twitter_Facebook_exploding*.

3 *See* "Ask the Analyst – Electronic Communications," NASD Regulation, *Regulatory & Compliance Alert* (Mar. 1999) ("March 1999 Ask the Analyst").

4 *See* NASD Rule 2210(a)(5).

5 *See Guide to the Internet for Registered Representatives,* at *www.finra.org/Industry/Issues/Advertising/p006118*.

6 *See* "Electronic Communications: Blogs, Bulletin Boards and Chat Rooms" (Feb. 23, 2009), and "Electronic Communications: Social Networking Web Sites" (Mar. 10, 2009) at *www.finra.org/ podcasts*.

FINRA is also hosting webinars on compliance considerations for social networking sites on February 3 and March 17, 2010. Find more information at *www.finra.org/webinars*.

7 *See*, SEC Rel. No. 34-37182 (May 9, 1996), 61 Fed. Reg. 24644 (May 15, 1996); SEC Rel. No. 34-38245 (Feb. 5, 1997), 62 Fed. Reg. 6469 (Feb. 12, 1997); *Notice to Members 03-33* (July 2003).

8 For example, even if FINRA considers a communication made through an interactive electronic forum to be a public appearance, the SEC staff could still conclude that Rule 482 under the Securities Act of 1933 and the filing requirements of Section 24(b) of the Investment Company Act of 1940 apply to the communication. Accordingly, firms must consider these requirements in determining whether to permit interactive electronic communications that discuss registered investment companies.

9 For example, in a Default Decision dated November 23, 2009, FINRA fined and suspended a registered principal who held put options for himself and issued unapproved bulletin board messages that urged investors to sell the underlying stock. The bulletin board messages omitted material disclosure regarding his interest in the stock.

10 Merriam-Webster's Online Dictionary, definition of "blog," at *http://www.merriam-webster.com/dictionary/BLOG*.

11 The key to this distinction between whether a blog is considered an advertisement versus an interactive electronic forum is whether it is used to engage in real-time interactive communications with third parties. Thus, the mere updating of a non-interactive blog (or any other firm Web page) does not cause it to become an interactive electronic forum, even if the updating occurs frequently.

12 Currently, NASD Rule 2210(b) requires that a registered principal of a firm approve all advertisements and sales literature prior to use either electronically or in writing. FINRA has proposed amendments to this rule. These amendments would retain this prior to use principal approval requirement for "retail communications" as defined in the proposal. *See Regulatory Notice 09-55* (Sept. 2009).

Endnotes Continued

13 *See, e.g.,* March 1999 Ask the Analyst, *supra* note 3.

14 *See Commission Guidance on the Use of Company Web Sites,* SEC Rel. No. 34-58288 (Aug. 1, 2008), 73 Fed. Reg. 45862, 45870 (Aug. 7, 2008) ("2008 SEC Release"); *Use of Electronic Media,* SEC Rel. No. 33-7856 (April 28, 2000), 65 Fed. Reg. 25843, 25848-25849 (May 4, 2000).

15 *See* 2008 SEC Release, *supra* note 14, 65 Fed. Reg. 45870 n.78.

16 *See* 47 U.S.C. § 230(c).

Regulatory Notice 17-18

Social Media and Digital Communications

Guidance on Social Networking Websites and Business Communications

Summary

This *Notice* provides guidance regarding the application of FINRA rules governing communications with the public to digital communications, in light of emerging technologies and communications innovations.

Questions concerning this *Notice* may be directed to:

- Joseph E. Price, Senior Vice President, Advertising Regulation/Corporate Financing, at (240) 386-4623, *Joseph.Price@finra.org*;
- Thomas A. Pappas, Vice President, Advertising Regulation, at (240) 386-4553, *Tom.Pappas@finra.org*; or
- Amy C. Sochard, Senior Director, Advertising Regulation, at (240) 386-4508, *Amy.Sochard@finra.org*.

Background

Previously, FINRA issued *Regulatory Notice 10-06* and *Regulatory Notice 11-39* to provide guidance on the application of FINRA rules governing communications with the public to social media sites and the use of personal devices for business communications. The *Notices* also remind firms of the recordkeeping, suitability, supervision and content requirements for such communications. Effective February 4, 2013, FINRA adopted amendments to Rule 2210 that codify guidance provided in the *Notices* with respect to the supervision of interactive social media posts by member firms.[1] In December 2014, FINRA published the Retrospective Rule Review Report: Communications with the Public, which recommended that FINRA consider more guidance. This Notice provides further guidance. It is not intended to alter the principles or the guidance provided in prior *Regulatory Notices*.

April 2017

Notice Type
- Guidance

Suggested Routing
- Advertising
- Compliance
- Legal
- Marketing
- Operations
- Registered Representatives
- Senior Management

Key Topics
- Business Communications
- Communications with the Public
- Digital Communications
- Native Advertising
- Recordkeeping
- Social Media
- Supervision

Referenced Rules and Notices
- FINRA Rule 2210
- FINRA Rule 4511
- Regulatory Notice 08-27
- Regulatory Notice 10-06
- Regulatory Notice 11-39
- Regulatory Notice 15-50
- SEA Rules 17a-3 and 17a-4

FINRA®
Financial Industry Regulatory Authority

An October 2015 study from the Pew Research Center indicates that 65 percent of adults use social networking sites as compared to 7 percent in 2005.[2] Social media and other websites frequently enable the use of "native advertising," which has been defined as advertising content that matches the form and function of the platform on which it appears.[3] Media articles have predicted that within the next five years revenue earned from native advertising in online publications such as periodicals and social media sites will outstrip other forms of online display advertising.[4]

An April 2015 Pew Research Center report stated that based on a telephone survey of 2,002 adults conducted in December 2014, 64 percent of American adults own a smart phone of some kind.[5] The same report indicated that based on a sampling survey of 1,635 respondents, 97 percent of smartphone owners used text messaging at least once during the 10-day study period in November 2014 making it the most widely used basic feature or application. In April 2016, Facebook Messenger reported 900 million monthly active users, and WeChat reported in March 2016 that it had added nearly 200 million monthly active users in the previous year. Consistent with these trends, firms have increasingly raised new questions regarding the application of FINRA rules to social media and digital communications.

Past Guidance

Recordkeeping

Regulatory Notices 10-06 and *11-39* remind firms of their obligation to retain records of digital communications that relate to their "business as such" as required by Rule 17a-4(b)(4) under the Securities Exchange Act of 1934 (SEA).[6] *Regulatory Notice 11-39* notes that determining whether a communication must be retained depends on its content and not upon the type of device or technology used to transmit the communication. The Notice also reminds firms that they must train and educate their associated persons regarding the differences between business and non-business communications and the measures required to ensure any business communication made by associated persons is retained, retrievable and supervised.

Third-Party Posts

Regulatory Notice 10-06 states that, as a general matter, posts by customers or other third parties on social media sites established by a firm or its personnel do not constitute communications with the public by the firm or its associated persons under Rule 2210; therefore, the pre-use principal approval, content and filing requirements of the rule do not apply to these posts. The same principle is generally true of posts by customers or other third parties on any website established by a firm or its associated persons, regardless of whether the site is part of a social network.

There are exceptions. *Regulatory Notice 10-06* states that third-party posts on a firm or associated person's business website may constitute communications with the public by the firm or an associated person under Rule 2210 if the firm or an associated person has (1) paid for or been involved in the preparation of the content (which FINRA would deem to be "entanglement") or (2) explicitly or implicitly endorsed or approved the content (which FINRA would deem to be "adoption").[7]

Hyperlinks to Third-party Sites

Regulatory Notice 11-39 states that a firm may not establish a link to any third-party site that the firm knows or has reason to know contains false or misleading content and may not include a link on its website if there are any red flags that indicate the linked site contains false or misleading content. The *Notice* also advises firms that they are responsible under the communications rules for content on a linked third-party site if the firm has adopted or has become entangled with its content. For example, a firm may have "adopted" third-party content if the firm indicates that it endorses the content on the third-party site or may be "entangled" with a third-party site if, for example, it participates in the development of the content on the third-party site.

Questions & Answers

The following questions and answers provide guidance only with respect to FINRA rules and do not interpret the rules of the SEC or any other federal or state agency.

Text Messaging

Q1: Investors have sought to interact with registered representatives through text messaging applications ("apps") and chat services. Is a firm required to retain records of communications related to its business that are made through text messaging apps and chat services?

A: Yes. As with social media, every firm that intends to communicate, or permit its associated persons to communicate, with regard to its business through a text messaging app or chat service must first ensure that it can retain records of those communications as required by SEA Rules 17a-3 and 17a-4 and FINRA Rule 4511. SEC and FINRA rules require that, for record retention purposes, the content of the communication determines what must be retained.[8]

Personal Communications

Q2: If an associated person of a firm in a personal communication shares or links to content that the firm makes available in its communications that does not concern the firm's products or services, would the associated person's communication be subject to Rule 2210? For example, if the associated person posts information about the firm's sponsorship of a charitable event, a human interest article, an employment opportunity, or employer information covered by state and federal fair employment laws, would the communication be subject to Rule 2210?

A: No. Whether a communication by an associated person is subject to Rule 2210 depends on whether the content relates to the products or services of the firm.

Hyperlinks and Sharing

Q3: If a firm shares or links to specific content posted by an independent third-party such as an article or video, has the firm adopted the content?

A: By sharing or linking to specific content, the firm has adopted the content and would be responsible for ensuring that, when read in context with the statements in the originating post, the content complies with the same standards as communications created by, or on behalf of, the firm.

Q4: Based on the previous question and answer, if the shared or linked content itself contains links to other content, has the firm adopted the content available at these additional links?

A: Solely by sharing or linking to content that contains links, a firm would not be responsible for the content available at such links. Additional facts and circumstances will determine whether the firm has adopted or become entangled with such content. In general, if a firm shares or links to content that in turn links to other content over which the firm has no influence or control, the firm would not have adopted the other content. In contrast, if a firm shares or links to content that in turn links to other content over which the firm *has* influence or control, the firm would then have adopted that other content.

In addition, where the firm shares or links to content that itself serves primarily as a vehicle for links, or where content available through such links forms the entire basis of the article, the firm would have adopted the other content accessed through such links (*e.g.*, a firm reposts a microblog post that promotes content through a link, or a firm links to a webpage made up largely of a link or links to other content).

Q5: If a firm includes on its website a link to a section of an independent third-party website, has it adopted the content of the third-party website?

A: Whether a firm has adopted the content of an independent third-party website or any section of the website through the use of a link is fact dependent. Two factors are critical to the analysis: (1) whether the link is "ongoing" and (2) whether the firm has influence or control over the content of the third-party site.

The firm has not adopted the content if the link is "ongoing," meaning:

- the link is continuously available to investors who visit the firm's site;
- investors have access to the linked site whether or not it contains favorable material about the firm; and
- the linked site could be updated or changed by the independent third-party and investors would nonetheless be able to use the link.

However, if the firm has any influence or control over the content of the third-party site, then the firm would be entangled with its content. Further, language introducing the ongoing link must conform to the content standards of the communications rules, including the prohibition of misleading or inaccurate statements or claims. Finally, as stated in *Regulatory Notice 11-39*, a firm may not establish a link to any third-party site that the firm knows or has reason to know contains false or misleading content.

Native Advertising

Q6: Native advertising has been defined as content that bears a similarity to the news, feature articles, product reviews, entertainment and other material that surrounds it online. For example, native advertising may be a video or article posted by an advertiser on an independent third party publisher's site that is presented alongside, and in a manner similar to, content posted by the publisher. Is native advertising inherently misleading under FINRA's communications rules?

A: Firms may use native advertising that complies with the applicable provisions of FINRA Rule 2210, including the requirements that firms' communications be fair, balanced and not misleading. In particular, native advertising must prominently disclose the firm's name, reflect accurately any relationship between the firm and any other entity or individual who is also named, and reflect whether mentioned products or services are offered by the firm as required by Rule 2210(d)(3).[9]

Q7: May firms arrange for comments or posts by an individual (an "influencer") that promote the firm's brand, products or services?

A: Where a firm has arranged for a comment or post to be made, FINRA would regard the firm as entangled with the resulting communication. For example, Regulatory Notice 08-27 states, "If a firm or representative has paid for the publication, production or distribution of any communication that appears to be a magazine, article or interview, then the communication must be clearly identified as an advertisement. FINRA regards this information as material to ensuring that such communications are not misleading." Consistent with this guidance and the prohibition of misleading or false communications in Rule 2210, firms should clearly identify as advertisements any communications that take the form of comments or posts by influencers and include the broker-dealer's name as well as any other information required for compliance with Rule 2210.

Testimonials and Endorsements

Q8: Social networking websites may allow individuals who have connected to another user on the network to give an opinion of, or provide comments regarding, the user's professional capabilities. If the user is a registered representative who has established a business-related site on the social network that is supervised and retained by the broker-dealer, are these opinions or comments considered testimonials for purposes of FINRA's communications rule?

A: FINRA does not regard unsolicited third-party opinions or comments posted on a social network to be communications of the broker-dealer or the representative for purposes of Rule 2210, including the requirements related to testimonials in paragraph (d)(6).

Rule 2210(d)(6), Testimonials, states that:

> (A) If any testimonial in a communication concerns a technical aspect of investing, the person making the testimonial must have the knowledge and experience to form a valid opinion.
>
> (B) Retail communications or correspondence providing any testimonial concerning the investment advice or investment performance of a member or its products must prominently disclose the following:
>
> > (i) The fact that the testimonial may not be representative of the experience of other customers.
> >
> > (ii) The fact that the testimonial is no guarantee of future performance or success.
> >
> > (iii) If more than $100 in value is paid for the testimonial, the fact that it is a paid testimonial.

Q9: A third party may post unsolicited favorable comments about a registered representative on the representative's business-use social media website. The representative may then like or share the comments. Under these circumstances, are the third-party comments deemed to be a communication of the representative and, therefore, subject to FINRA's communications rules?

A: By liking or sharing the favorable comments, the representative has adopted them and they are subject to the communications rules, including the prohibition on misleading or incomplete statements or claims, the testimonial requirements noted above, and the supervision and recordkeeping rules.[10]

Q10: How may a registered representative or firm include the disclosures required for a testimonial in an interactive electronic communication?

A: The disclosures may be provided in the interactive electronic communication itself in close proximity to the testimonial or the disclosures may be made through a clearly marked hyperlink accompanying the testimonial using language such as **"important testimonial information,"** provided of course that the testimonial is not false, misleading, exaggerated or promissory.

Firms registered under the Investment Advisers Act of 1940 (Advisers Act) should be aware that Section 206(4) generally prohibits any investment adviser from engaging in any act, practice or course of business that the Commission, by rule, defines as fraudulent, deceptive or manipulative. In particular, Advisers Act Rule 206(4)-1(a)(1) states that "[i]t shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business . . . for any investment adviser registered or required to be registered under [the Advisers Act], directly or indirectly, to publish, circulate, or distribute any advertisement which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report or other service rendered by such investment adviser."

Correction of Third-party Content

Q11: Suppose that an unaffiliated third-party publisher posts an online directory of businesses and includes information about registered representatives of a broker-dealer. Neither the firm nor the registered representatives requested, solicited or paid for the posting of these listings. If the firm or representative contacts the publisher to alert it to a factual error (*e.g.*, a misspelled name; incorrect street, website or email address; incorrect phone numbers), would the corrected listings be considered a communication of the firm or the representative?

A: When the correction pertains to factual information related to the directory listing alone, the fact that the firm or representative contacted the publisher would not mean that the corrected listing is a communication of the firm or the representative. Firms also may correct the error by posting a comment on the listing that includes the correct information without being deemed to have adopted the original, incorrect listing.

BrokerCheck

Q12: As announced in *Regulatory Notice 15-50*, effective June 6, 2016, FINRA amended Rule 2210 to require each of a firm's websites to include a readily apparent reference and hyperlink to BrokerCheck on (1) the initial web page that the firm intends to be viewed by retail investors, and (2) any other web page that includes a professional profile of one or more registered persons who conduct business with retail investors. To assist firms in complying with this new requirement, FINRA developed *BrokerCheck-related icons and similar resources*. *Regulatory Notice 15-50* states that a firm need not include a readily apparent reference and hyperlink to BrokerCheck from communications appearing on a third-party website including social media sites or in email or text messages. Does the requirement to include a readily apparent reference and hyperlink to BrokerCheck apply to an app created by a firm?

A: No. Because Rule 2210(d)(8) specifically references websites, there is no requirement to include a reference and hyperlink to BrokerCheck in an app. However, if an app accesses and displays a webpage on the firm's website that is required to include the BrokerCheck link under the rule, the firm must ensure that the link is readily apparent when the page is displayed through the app.

Endnotes

1. Rule 2210(b)(1)(D) excepts from the prior-to-use principal approval requirement of Rule 2210(b)(1)(A) retail communications posted on an online interactive electronic forum that the firm supervises and reviews in the same manner as correspondence as set forth in Rule 3110(b) and 3110.06 through .09. Rule 2210(c)(7)(M) excludes from filing with FINRA's Advertising Regulation Department any retail communication that is posted on an online interactive electronic forum. FINRA provided additional guidance regarding these exceptions in a question and answer published in *Regulatory Notice 15-17*.

2. *See* Andrew Perrin, Pew Research Center, Internet Science & Tech, *Social Media Usage: 2005-2015* (October 8, 2015).

3. In its *Native Advertising: A Guide for Business*, the Federal Trade Commission (FTC) describes native advertising as "content that bears a similarity to the news, feature articles, product reviews, entertainment, and other material that surrounds it online."

4. *See* *Business Insider, "Native ads will drive 74% of all ad revenue by 2021,"* (June 14, 2016) and *The Huffington Post, "2016 Native Advertising Trends For Publishers"* (June 21, 2016).

5. *See* Aaron Smith, Pew Research Center, Internet, Science & Tech, *U.S. Smartphone Use in 2015* (April 1, 2015).

6. SEA Rule 17a-4(b) requires broker-dealers to preserve certain records for a period of not less than three years, the first two in an easily accessible place. Among these records, pursuant to SEA Rule 17a-4(b)(4), are "[o]riginals of all communications received and copies of all communications sent (and any approvals thereof) by the member, broker or dealer (including inter-office memoranda and communications) relating to its business as such, including all communications which are subject to rules of a self-regulatory organization of which the member, broker or dealer is a member regarding communications with the public." *See also* FINRA Rule 2210(b)(4)(A) (requiring retention of communications with the public) and FINRA Rule 4511 (requiring members to make and preserve books and records).

7. The SEC first articulated these approaches as a basis for a company's responsibility for third-party information that is hyperlinked to its website. See Commission Guidance on the Use of Company Web Sites, SEC Rel. No. 34-58288 (Aug. 1, 2008), 73 Fed. Reg. 45862, 45870 (Aug. 7, 2008); Use of Electronic Media, SEC Rel. No. 33-7856 (April 28, 2000), 65 Fed. Reg. 25843, 25848-25849 (May 4, 2000). FINRA applies a similar analysis to third-party posts on social media or other websites established by the firm or its personnel. *See also* IM Guidance Update No. 2014-04, Guidance on the Testimonial Rule and Social Media (March 2014) for more information.

8. *See* SEC Rel. No. 34-37182 (May 9, 1996), 61 Fed. Reg. 24644 (May 15, 1996); SEC Rel. No. 34-38245 (Feb. 5, 1997), 62 Fed. Reg. 6469 (Feb. 12, 1997); *Notice to Members 03-33 (July 2003)*; and SEC Office of Compliance Inspections and Examinations National Examination Risk Alert, Investment Adviser Use of Social Media, (January 4, 2012) .

9. *See also*, the guidance provided in the FTC's Enforcement Policy Statement on Deceptively Formatted Advertisements, December 22, 2015.

10. In *Regulatory Notice 11-39*, FINRA stated: "The fact that the firm has a policy of routinely blocking or deleting certain types of content in order to ensure the content is appropriate would not mean that the firm had adopted the content of the posts left on the site. For example, most firms using social media sites block or screen offensive material. Such a policy would not indicate that the firm has adopted the remaining third-party content."

Social Media Influencers, Customer Acquisition, and Related Information Protection

September 2021

FINRA is conducting a review of firm practices related to the acquisition of customers through social media channels and how firms manage their obligations related to information collected from those customers and other individuals that may provide data to firms. Please note that each item requested is specific to the subsection header.

Unless otherwise noted, the relevant period for each request is January 1, 2020 through [*Date*, 2021] (the "Relevant Period"). In addition, if your response varies over the Relevant Period, please explain the differences in your response.

Definitions:

"Social Media" means any website or application that enables users to create and share content or participate in social networking. It includes, but is not limited to, TikTok, Facebook, Instagram, YouTube, Twitter, StockTwits, Reddit, and Twitch.

"Social Media Communications" means any communication with the public, including the provision of any content or advertisement about or on behalf of the firm, made pursuant to an arrangement with a third party, through Social Media.

"Referral Program" means any customer or account referral program offered or used by the firm through which individuals receive bonuses, rewards, incentives, or other compensation for referring new customers to open accounts at the firm.

"Social Media Influencers" or "Influencers" means any third party with whom the firm contracts or compensates to provide Social Media Communications.

"Nonpublic Personal Information (NPI)" is defined as that term is defined in 17 CFR § 248.3.

"Cookie" means any data generated by a website or mobile application about a user and then saved.

Social Media Influencers

1. Describe whether the firm, or its affiliate(s) on its behalf, finds and/or contracts with individuals or entities to provide Social Media Communications. If the firm engaged in such activity:

    a. Describe how the firm finds and/or contracts with individuals or entities to provide Social Media Communications, including whether and how the firm uses third parties, vendors, or services to find, contract, and/or compensate individuals or entities for Social Media Communications.

    b. Provide any engagement letters, contracts, agreements, or any other written, or offered arrangements in which the firm (or any affiliate of the firm) contracted to compensate individuals or entities to provide Social Media Communications. Please include any amendments to those engagement letters, contracts, agreements, or written arrangements.

    c. Describe and identify any individuals or entities with which the firm (or any affiliate of the firm) maintains any non-written agreements, or offers, to compensate individuals or entities to provide Social Media Communications.

    d. For the Relevant period, provide all Social Media Communications about the firm distributed or made available by individuals or entities identified above. A complete response to this request will include: (1) any Social Media Communications posted by the firm on the Influencer's social media account(s) and (2) any Social Media Communications the Influencer posted on any social media platform about the firm.

    e. Provide a numbered tabular list identifying each Social Media Communication provided pursuant to Item 1(d) above. Please also include the date the Social Media Communication was first made available to the public and whether or not the Social Media Communication was filed with FINRA's Advertising Regulation Department. If the Social Media Communication was filed, include the FINRA Advertising Regulation reference number for the communication.

f. State whether each Social Media Communication provided pursuant to Item 1(d) above was approved by a registered principal of the firm. If so, provide records that reflect such approvals.

2. Describe the criteria the firm uses to identify potential Influencers to recruit as well as any background information or other characteristics, if any, the firm considers when avoiding the use of particular Influencers.

3. Provide copies of any firm social media postings, website content, emails or other communications designed to recruit individuals to post Social Media Communications regarding or on behalf of the firm.

Referral Programs:

4. Describe whether the firm, or its affiliate(s) on its behalf, offered Referral Programs) during the Relevant Period. If the firm engaged in such activity, describe:

   a. The time period during which the Referral Program was or is in effect;

   b. The terms of the Referral Program;

   c. Eligibility requirements;

   d. Any restrictions concerning the Referral Program;

   e. Compensation, benefits, or bonuses offered through the Referral Program and the methodology for determination;

5. Provide copies of any firm social media postings, website content, emails, or other communications designed to recruit individuals, including Firm customers, to participate in any Referral Program identified in response to Request 4 above.

General Information related to Social Media Influencers and Referral Programs:

If the firm answered affirmatively to Request nos. (1) or (4):

6. Provide all versions of the firm's written supervisory procedures that were in effect at any time during the Relevant Period relating to:

   a. Social media communications by outside parties relating to the firm, including the method by which the firm supervises such activity;

   b. Use of marketing affiliates or relationships to refer new customers to the firm; and

   c. Referral Programs.

7. Provide any compliance policies, manuals, training materials, compliance bulletins, and any other written guidance in effect for any portion of the Relevant Period concerning Social Media Communications, use of marketing affiliates, and Referral Programs.

8. Describe how the firm maintains records of Social Media Communications created by Influencers as well as Social Media Communications made by the individuals or entities participating in its Referral Programs.

9. State whether the firm required Influencers, or the individuals or entities participating in its Referral Programs -- to attend trainings and/or educational courses prior to providing Social Media Communications in connection with the firm. If the answer is in the affirmative, provide a detailed explanation of the firm's requirements, the training and/or educational courses required, and the firm's method for tracking completion by Influencers and participants in the Referral Programs. Please identify which training and/or educational courses were for Influencers and which were for the Referral Program.

10. Provide copies of any policies, manuals, training materials, compliance bulletins, and any other written guidance provided to Influencers as well individuals or entities participating in the firm's Referral Program. Please identify which material was provided to Influencers and which was provided to Referral Program participants.

Items related to Regulation S-P and Usage Information:

11. Provide the firm's written supervisory procedures concerning its compliance with the SEC's Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Personal Information (Regulation S-P). Include a description of the firm's supervisory system during the Relevant Period concerning compliance with Regulation S-P with regard to the collection of Cookies obtained from customers, or individuals who provide NPI but are not onboarded as customers.

12. Provide all versions of all initial privacy notices, *see* 17 CFR § 248.4, that the firm used at any time during the Relevant Period.

13. To the extent not provided in response to the prior request, provide all versions of all opt-out notices, *see* 17 CFR § 248.7, that the firm used at any time during the Relevant Period.

14. Provide all versions of all annual privacy notices, *see* 17 CFR § 248.5, that the firm used at any time during the Relevant Period.

15. Provide any desk top procedures, compliance policies, manuals, training materials, compliance bulletins, and any other written guidance in effect for any portion of the Relevant Period concerning the sharing of any customer NPI with any third party.

16. Provide any desk top procedures, compliance policies, manuals, training materials, compliance bulletins, and any other written guidance in effect for any portion of the Relevant Period concerning individuals' ability to opt-out of information sharing.

17. Describe all types of data the firm tracks (or has tracked at any time during the Relevant Period), through the use of a Cookie or otherwise, in connection with its customers' usage of (a) the firm's website and/or (b) the firm's mobile application (collectively "Usage Information"). Include individuals who provide NPI but are not onboarded as customers.

18. Provide a list of all non-affiliated third parties with which the firm or any affiliate of the firm shares (or has shared at any time during the Relevant Period) any Usage Information.[1] In addition, for each third party, provide the following information:

    a. A list of each type of Usage Information shared with that third party;

    b. Whether the data shared with the third party is anonymized;

    c. The firm's understanding of the third party's intended use of the Usage Information;

    d. How or to what extent the third party restricts access to Usage Information and describe the controls in place;

    e. The number of individuals whose Usage Information the firm or any affiliate of the firm shared with that third party during the Relevant Period;

    f. All written contracts or agreements between the firm (or, if applicable, the firm's affiliated entity) and the third party concerning any Usage Information in force at any time during the Relevant Period; and

    g. Any compensation or benefit (including but not limited to monetary payments, reductions of amounts otherwise due, reciprocal sharing of information, and/or other non-monetary benefit) received by the firm or any of the firm's affiliated entities in any way related to the sharing of any Usage Information with that third party.

19. Provide any disclosures the firm provided to customers during the Relevant Period concerning any Usage Information shared with non-affiliated third parties and whether individuals identified in response to item 18 consented to the sharing of Usage Information.

20. Provide any exception reports or any other memoranda that reflect instances during the Relevant Period in which the firm failed to comply with Regulation S-P as a result of its sharing of Usage Information with any non-affiliated third party. Provide copies of all documents concerning the firm's identification, investigation, and/or reporting of any such instances, or concerning the firm's consideration of whether to report the same.

---

1 Exclude from your response to this request any Usage Information shared with: any state, federal, or foreign regulator or other governmental entity; any self-regulatory organization; law enforcement; any clearing firm; any other financial institution pursuant to Section 314(b) of the USA PATRIOT Act; any party in response to a subpoena, court order, or discovery request; the customer or any other party as requested by the customer; or any other sharing mandated by law.

Hot Topics in FinTech
Monday, May 16, 2022
3:00 p.m. – 4:00 p.m.

Join FINRA staff and industry practitioners as they discuss the growing area of FinTech (Financial Technology). The session includes a discussion on new and innovative ways firms are integrating fintech into their business models and the importance of a strong compliance structure to address regulatory obligations.

Moderator:
Steven Price
Senior Vice President, National Cause Program
FINRA Member Supervision

Panelists:
Alan Carlisle
Chief Compliance Officer
SoFi

Robert Chao
Senior Director, Retail Risk Monitoring
FINRA Member Supervision

Nicole Murphy
Chief Compliance Officer
Cash App Investing LLC

Hot Topics in FinTech Panelists Bios:

Moderator:

Steven Price is Senior Vice President and oversees FINRA's National Cause Program, which conducts assessments and investigations of financial industry participants across the U.S. based on triggering events and regulatory intelligence. He also participates in multiple organizational committees and initiatives designed to establish FINRA as a leader in regulatory vision and to advance the protection of investors. Mr. Price re-joined FINRA in 2020 after spending the previous 12 years in multiple roles overseeing broker-dealer compliance and operations for ALPS Distributors and ALPS Portfolio Solutions Distributor. He formerly served in the enforcement units of FINRA and the Colorado Division of Securities, as well as serving on the Colorado Securities Board. Prior to his regulatory roles, Mr. Price was a market maker at the Chicago Board Options Exchange and a litigator with concentration across civil and criminal matters.

Panelists:

Alan Carlisle is Enterprise Chief Compliance Officer at SoFi and is responsible for the oversight of the compliance management program for SoFi Technologies, Inc. (Ticker: SOFI) and all of its subsidiaries. With almost 25 years of experience in the financial services industry and capital markets, Mr. Carlisle has worked with a broad array of broker dealer business models, including FinTech, Independent, Retail and Institutional firms. His expertise lies in design and implementation of risk and compliance controls, application of existing regulatory frameworks to innovative technologies, and assessing the overall strengths and weaknesses of compliance approach and discipline. He holds the Series 4, 7, 9, 10, 24, 27, 53, 55, 63, 65, 79 and 99 securities licenses, as well as the CRCP®, CRCM, CAMS, CAFP, CGSS, CIPP/US, CIPM, CCIM, and LEED AP BD+C/O+M credentials.

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.

Nicole Murphy is Chief Compliance Officer for Cash App Invest LLC and has served in this capacity since October 2021. In this role, she is responsible for overseeing regulatory compliance and supervision for the continuously evolving and innovative broker-dealer within a broader fintech organization. Ms. Murphy is also Cash App Invest's AML Officer and serves on several internal committees. Since joining the industry in 2007, Ms. Murphy has contributed to the Retail and Operations business units at TD Ameritrade and TD Ameritrade Clearing and the Regulatory Relations organization at E*TRADE and Morgan Stanley. Ms. Murphy received her Bachelor of Arts degree from Creighton University where she majored in Philosophy with a co-major in Political Science. She also currently holds her Series 7, 63, and 24 licenses.

Hot Topics in FinTech

Panelists

- **Moderator**
  - Steven Price, Senior Vice President, National Cause Program, FINRA Member Supervision
- **Panelists**
  - Alan Carlisle, Chief Compliance Officer, SoFi
  - Robert Chao, Senior Director, Retail Risk Monitoring, FINRA Member Supervision
  - Nicole Murphy, Chief Compliance Officer, Cash App Investing LLC

Hot Topics in FinTech
Monday, May 16, 2022
3:00 p.m. – 4:00 p.m.

Resources:

- FINRA FinTech Page

  www.finra.org/rules-guidance/key-topics/fintech

- FINRA Cloud Computing in the Securities Industry Page

  www.finra.org/rules-guidance/key-topics/fintech/report/cloud-computing

- FINRA Artificial Intelligence (AI) in the Securities Industry Report (June 2020)

  www.finra.org/sites/default/files/2020-06/ai-report-061020.pdf

- FINRA Following the Crowd: Investing and Social Media

  www.finra.org/investors/alerts/following-crowd-investing-and-social-media

- FINRA Unscripted: *AI Virtual Conference: Industry Views on the State of Artificial Intelligence* (November 2020)

  www.finra.org/media-center/finra-unscripted/ai-conference-artificial-intelligence

Navigating the Clearing Relationship
Monday, May 16, 2022
3:00 p.m. – 4:00 p.m.

This session is designed to assist firms in making the most of the relationship with their clearing firm. Panelists discuss types of data and services clearing firms offer, and practices for integrating these tools into introducing firms' compliance processes.

Moderator:
Michael MacPherson
Senior Director, Risk Monitoring Program
FINRA Member Supervision

Panelists:
Rajeev Khurana
Chief Legal Officer
Apex Clearing Corporation

John Martino
Senior Director, Diversified, Carry & Clearing Firm Examinations
FINRA Member Supervision

Navigating the Clearing Relationship Panelists Bios:

Moderator:

Michael MacPherson is Examination Director in FINRA Member Supervision and is positioned in the Diversified/Carry-Clearing Firm Group. Mr. MacPherson serves on several workstreams, including Examination Findings/Themes and Quality Assurance Enhancements. Prior to his employment at FINRA, Mr. MacPherson served as a Director in the Regulatory Reporting at National Financial Services, and as a Senior Vice President in the Regulatory Reporting department at Citigroup. Mr. MacPherson holds a bachelor's degree in Finance from St. John's University and maintains a Series 27 license.

Panelists:

Rajeev Khurana is Chief Legal Officer and Secretary of Apex Fintech Solutions and its subsidiary Apex Clearing Corporation where in addition to leading various corporate governance and second-line functions, he leads the legal team responsible for drafting and negotiating clearing agreements. Prior to joining Apex, Mr. Khurana led the Corporate, Securities and Finance group in Discover Financial Services' legal organization. Additionally, Mr. Khurana supported Discover's board of directors and oversaw the day-to-day operations of the corporate secretary's office. Mr. Khurana began his career as a transactional lawyer at Mayer Brown LLP in Chicago focused on securities, lending and structured finance transactions. Mr. Khurana received his J.D. from IIT-Chicago Kent College of Law in 2008 with high honors where he was an executive editor of the *Chicago-Kent Law Review* and a member of the Order of the Coif. Mr. Khurana received a bachelor of the arts degree from Case Western Reserve University where he majored in economics and political science.

John Martino is Senior Director of Examinations for FINRA member firms assigned to the Diversified and Clearing and Carrying firm groupings. In this role, he has responsibility for the Examination teams assigned to these firms, which includes the execution of financial, operational, and business conduct risks. He and his team coordinate closely with Risk Monitoring on the development of examination strategy. He has also served on several internal FINRA committees responsible for redesigning the organization's Examination program, including the infrastructure used to facilitate those exams. Mr. Martino previously held responsibilities as both a Surveillance and Examination Director in the Risk Oversight and Operational Regulation group of Member Supervision, where he oversaw the financial and operational risk assessment and exam execution of some of FINRA's largest, most systemically important member firms. Mr. Martino has been with the organization since its inception in 2007. Prior to joining FINRA, he spent 4 years at the New York Stock Exchange as a Financial Operations examiner. Mr. Martino holds a BBA in Finance from Hofstra University.

Navigating the Clearing Relationship

Panelists

- **Moderator**
  - Michael MacPherson, Senior Director, Risk Monitoring Program, FINRA Member Supervision
- **Panelists**
  - Rajeev Khurana, Chief Legal Officer, Apex Clearing Corporation
  - John Martino, Senior Director, Diversified, Carry & Clearing Firm Examinations, FINRA Member Supervision

Navigating the Clearing Relationship
Monday, May 16, 2022
3:00 p.m. – 4:00 p.m.

Resources:

- FINRA Rule 4311. Carrying Agreements

  www.finra.org/rules-guidance/rulebooks/finra-rules/4311

- FINRA *Notice to Members 02-57, Use of Negative Response Letters for the Bulk Transfer of Customer Accounts* (September 2002*)*

  www.finra.org/rules-guidance/notices/02-57

- SEC Letter, Broker-Dealers Borrowing Fully Paid and Excess Margin Securities from Customers (October 22, 2020*)*

  www.sec.gov/divisions/marketreg/mr-noaction/2020/finra-fpl-20201022-15c3-3.pdf

Insider Trading, Fraud and Market Abuse
Monday, May 16, 2022
3:00 p.m. – 4:00 p.m.

This session focuses on recent or noteworthy insider trading, fraud and market abuse cases. Panelists highlight emerging trends, provide tips to identify potential “red flags”, and discuss who to contact if a fraudulent scheme is suspected.

Moderator:

Sam Draddy
Senior Vice President, Market Investigations Team
FINRA Member Supervision

Panelists:

Karen Braine
Senior Director, Insider Trading
FINRA Member Supervision

Jason Foye
Senior Director, Special Investigations Unit
FINRA Member Supervision

Jackie Perrell
Vice President, Market Fraud Investigations
FINRA Member Supervision

Insider Trading, Fraud and Market Abuse Panelists Bios:

Moderator:

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.

Panelists:

Karen Braine leads the FINRA Insider Trading Investigations Team which conducts surveillance and investigations for the entire U.S. marketplace. Ms. Braine started her career in financial services in 1993 and joined FINRA in 2007 as an Investigator. Ms. Braine received her undergraduate degree from Western Kentucky University, and holds the CRCP®, CFE and ACAMS designations.

Jason Foye is Director of FINRA's AML Investigative Unit, a specialized team that conducts complex Anti-Money Laundering examinations, provides guidance to FINRA's examination and Enforcement staff in connection with AML-related matters, and provides education and training to FINRA staff and industry personnel throughout the country. Mr. Foye serves as an AML Regulatory Specialist within FINRA and is Certified Anti-Money Laundering Specialist and a Certified Fraud Examiner. Mr. Foye graduated from Florida State University with a Bachelor's degrees in Finance and Risk Management. Mr. Foye works from FINRA's Florida District Office, and has been with FINRA for 11 years.

Jackie Perrell is Vice President in the NCFC Market Investigations Team and the head of Market Fraud Investigations. Ms. Perrell previously served as a Vice President and Senior Advisor within Member Supervision's Office of the Chief of Staff, leading a team responsible for supporting a variety of operational, administrative support, and financial management functions across Member Supervision, as well as serving as an advisor on a wide range of operational, policy and regulatory issues. Since joining FINRA in 2011, Ms. Perrell has held a variety of positions within the organization, beginning as an attorney in the Department of Enforcement where she conducted investigations involving potential violations of FINRA rules and the federal securities laws and rules thereunder. She then worked in the Office of the Whistleblower where she managed investigations of complaints and regulatory tips alleging potential fraud and other regulatory misconduct, and then transitioned to serving as a Deputy Director in the Office of Fraud Detection and Market Intelligence (OFDMI) where she served as a key member of the OFDMI senior management team. Prior to joining FINRA, Ms. Perrell worked in private practice representing broker-dealers in connection with SEC and FINRA investigations and in FINRA's arbitration forum, served as an Administrative Law Judge for the State of Maryland presiding over contested administrative law hearings, and worked as a staff attorney in the SEC's Office of Compliance Inspections and Examinations conducting examinations of broker-dealers and self-regulatory organizations.

Insider Trading, Fraud and Market Abuse

Panelists

- **Moderator**
  - Sam Draddy, Senior Vice President, Market Investigations Team, FINRA Member Supervision
- **Panelists**
  - Karen Braine, Senior Director, Insider Trading, FINRA Member Supervision
  - Jason Foye, Senior Director, Special Investigations Unit, FINRA Member Supervision
  - Jackie Perrell, Vice President, Market Fraud Investigations, FINRA Member Supervision

Russian Trading Scheme

Press Release

SEC Charges Five Russians in $80 Million Hacking and Trading Scheme

FOR IMMEDIATE RELEASE
2021-265

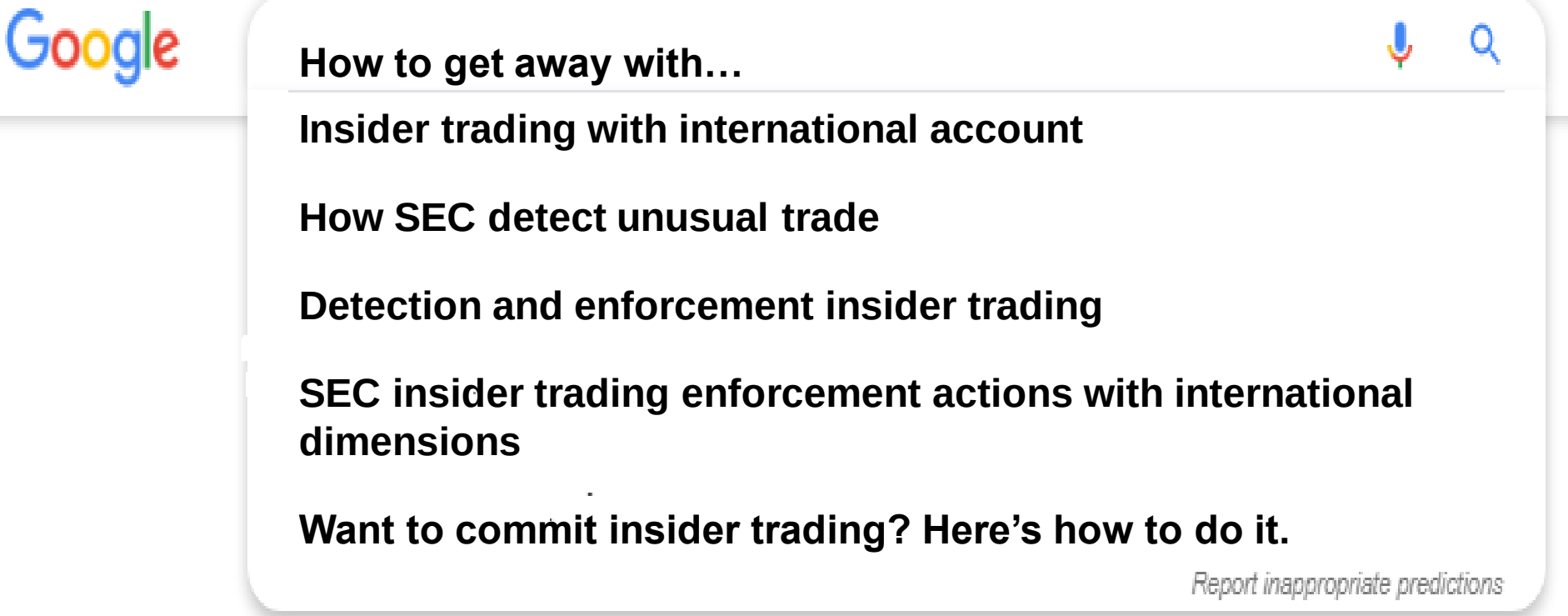
Washington D.C., Dec. 20, 2021 — The Securities and Exchange Commission today announced fraud charges against five Russian nationals for engaging in a multi-year scheme to profit from stolen corporate earnings announcements obtained by hacking into the systems of two U.S.-based filing agent companies before the announcements were made public. The filing agents assist publicly traded companies with the preparation and filing of periodic reports with the SEC, including quarterly reports containing earnings information.

The SEC's complaint, filed in federal district court in Massachusetts, alleges that defendant Ivan Yermakov used deceptive hacking techniques to access the filing agents' systems and directly or indirectly provided not-yet-public corporate earnings announcements stolen from those systems to his co-defendants Vladislav Kliushin, Nikolai Rumiantcev, Mikhail Irzak, and Igor Sladkov. According to the complaint, from 2018 through 2020, the traders used 20 different brokerage accounts located in Denmark, the United Kingdom, Cyprus and Portugal to generate profits of at least $82 million using the stolen information to make trades before over 500 corporate earnings announcements. The defendants allegedly shared a portion of their enormous profits by funneling them through a Russian information technology company founded by Kliushin and for which Yermakov and Rumiantcev serve as directors.

"With this action, the SEC, using its powerful analytical tools, has exposed a highly sophisticated and deceptive scheme to steal and monetize non-public corporate information," said Gurbir S. Grewal, Director of the SEC's Division of Enforcement. "While we remain steadfast in our commitment to protect the integrity of our securities markets against bad actors no matter where they are located or what sophisticated tactics they use, we strongly encourage companies to shore up their safeguards against, and remain vigilant for cyber breaches that compromise their non-public information."

The U.S. Attorney's Office for the District of Massachusetts today announced criminal charges against the five defendants named in the SEC's action and that defendant Vladislav Kliushin was extradited from Switzerland.

Google Fail:


Google
How to get away with…
Insider trading with international account
How SEC detect unusual trade
Detection and enforcement insider trading
SEC insider trading enforcement actions with international dimensions
Want to commit insider trading? Here's how to do it.
Report inappropriate predictions

Zenosense, Inc. (OTC: ZENO)

FINRA's *Dirty Laundry List*

Lord Global Corporation (OTC: LRDG)

New Account Fraud and Account Takeover Fraud

Resource	Description
RN 20-13	FINRA Reminds Firms to Beware of Fraud During the COVID-19 Pandemic
RN 20-32	FINRA Reminds Firms to Be Aware of Fraudulent Options Trading in Connection With Potential Account Takeovers and New Account Fraud
RN 21-14	FINRA Alerts Firms to Recent Increase in ACH "Instant Funds" Abuse
RN 21-18	FINRA Shares Practices Firms Use to Protect Customers From Online Account Takeover Attempts
FIN-2011-A016	FinCEN Advisory on Account Takeover Activity
FIN-2016-A005	FinCEN Advisory to Financial Institutions on Cyber-Events and Cyber-Enabled Crime
FIN-2020-A005	FinCEN Advisory on Cybercrime and Cyber-Enabled Crime Exploiting the COVID-19 Pandemic
FIN-2021-A002	FinCEN Advisory on Financial Crimes Targeting COVID-19 Economic Impact Payments

Guidance and Resources

Treasury/FinCEN Resources

- Updates on AML Act of 2020
- National Money Laundering Risk Assessment (2022)
- FinCEN Examines Identity Theft-Related Suspicious Activity Reports (2011)
- FinCEN Study examines Rise in Identity Theft SARs (2010)

Federal Reserve Resources

- Synthetic Identity Fraud Mitigation Toolkit

Securities and Exchange Commission (SEC) Resources

- 2022 Exam Priorities
- Identity Theft Red Flags Rule (Regulation S-ID)

FINRA Resources

- 2022 Report on FINRA's Examination and Risk Monitoring Program
- FINRA Unscripted Podcast (Overlapping Risks: AML and Cybersecurity)
- FINRA Unscripted Podcast (At, by or through: Fraud in the Broker-Dealer Industry)
- Identity Theft Red Flags Rule (Regulation S-ID) Template

Sharing Intelligence with FINRA

- Contact risk monitoring
- File a regulatory tip with FINRA:
  - *www.finra.org/contact-finra/file-tip*
  - Tips can be filed anonymously
- Send FINRA BSA IDs with actionable intelligence to BSA@finra.org.

Insider Trading, Fraud and Market Abuse
Monday, May 16, 2022
3:00 p.m. – 4:00 p.m.

Resources:

- FINRA *Regulatory Notice 21-14, FINRA Alerts Firms to Recent Increase in ACH "Instant Funds" Abuse* (March 2021)

  www.finra.org/rules-guidance/notices/21-14

- FINRA *Regulatory Notice 21-18, FINRA Shares Practices Firms Use to Protect Customers From Online Account Takeover Attempts* (May 2021)

  www.finra.org/rules-guidance/notices/21-18

- FINRA *Regulatory Notice 20-13, FINRA Reminds Firms to Beware of Fraud During the Coronavirus (COVID-19) Pandemic* (May 2020)

  www.finra.org/rules-guidance/notices/20-13

- FINRA *Regulatory Notice 20-32, FINRA Reminds Firms to Be Aware of Fraudulent Options Trading in Connection With Potential Account Takeovers and New Account Fraud* (September 2020)

  www.finra.org/rules-guidance/notices/20-32

- 2022 Report on FINRA's Examination and Risk Monitoring Program (February 2022)

  www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program

- FINRA Unscripted: Overlapping Risks, Part 1: Anti-Money Laundering and Cybersecurity (October 2020)

  www.finra.org/media-center/finra-unscripted/aml-cybersecurity

- FINRA Unscripted: At, By or Through: Fraud in the Broker-Dealer Industry (April 2021)

  www.finra.org/media-center/finra-unscripted/fraud-broker-dealer-industry

- SEC Identity Theft Red Flags Rule (Regulation S-ID) Template

  www.finra.org/rules-guidance/key-topics/customer-information-protection/ftc-red-flags-rule

- 2022 SEC Examination Priorities: Division of Examinations Report

  www.sec.gov/files/2022-exam-priorities.pdf

- CFTC and SEC Joint Rules and Guidelines: Identity Theft Red Flags Rules

  www.sec.gov/rules/final/2013/34-69359.pdf

- The Federal Reserve: Synthetic Identity Fraud Mitigation Toolkit

  www.fedpaymentsimprovement.org/synthetic-identity-fraud-mitigation-toolkit/

- FinCEN The Anti-Money Laundering Act of 2020

  www.fincen.gov/anti-money-laundering-act-2020

- Department of the Treasury: 2022 National Money Laundering Risk Assessment (February 2022)

  www.home.treasury.gov/system/files/136/2022-National-Money-Laundering-Risk-Assessment.pdf

- *FinCEN Examines Identity Theft-Related Suspicious Activity Reports Filed by Securities & Futures Firms Trends in Illicit Activity Uncovered* (September 06, 2011)

  www.fincen.gov/news/news-releases/fincen-examines-identity-theft-related-suspicious-activity-reports-filed

- *FinCEN Study Examines Rise in Identity Theft SARs* (October 18, 2010)

  www.fincen.gov/news/news-releases/fincen-study-examines-rise-identity-theft-sars

- FinCEN *Advisory: Financial Crimes Targeting COVID-19 Economic Impact Payments*, FIN-2021-A002, (February 24, 2021)

  www.fincen.gov/sites/default/files/advisory/2021-02-25/Advisory%20EIP%20FINAL%20508.pdf

- FinCEN *Advisory: Cybercrime and Cyber-Enabled Crime Exploiting the COVID-19 Pandemic*, FIN-2020-A005, (July 30, 2020)

  www.fincen.gov/sites/default/files/advisory/2020-07-30/FinCEN%20Advisory%20Covid%20Cybercrime%20508%20FINAL.pdf

- FinCEN *Advisory: Financial Institutions on Cyber-Events and Cyber-Enabled Crime*, FIN-2016-A005, (October 25, 2016)

  www.fincen.gov/sites/default/files/advisory/2016-10-25/Cyber%20Threats%20Advisory%20-%20FINAL%20508_2.pdf

- FinCEN *Advisory: Account Takeover Activity*, FIN-2011-A016, (December 19, 2011)

  www.fincen.gov/sites/default/files/advisory/FIN-2011-A016.pdf

Alternative Investments and Complex Products
Monday, May 16, 2022
3:00 p.m. – 4:00 p.m.

This session addresses developments related to alternative investments and complex products. The session emphasizes the importance of understanding product features, characteristics, and their supervisory challenges.

Moderator:
Joseph Price
Senior Vice President, Corporate Financing & Advertising Regulation
FINRA Corporate Financing & Advertising Regulation

Panelists:
Brad Anderson
Chief Compliance Officer
DFPG Investments, LLC

Kelly Rock, Esq.
Senior Counsel, Complex Financial Instruments Unit
U.S. Securities and Exchange Commission (SEC)

Thomas Selman, CFA
Founder
Scopus Financial Group

Alternative Investments and Complex Products Panelists Bios:

Moderator:

Joseph E. Price is Senior Vice President, Regulatory Analysis. He oversees FINRA's Corporate Financing and Advertising Regulation Departments. The Corporate Financing Department regulates capital-raising activities of broker/dealers; including equity, debt, REIT, closed-end fund, limited partnership offerings and private placements. The Advertising Regulation Department regulates broker/dealer sales materials, mutual fund advertisements, social media and other communications with the public. Mr. Price previously worked in various capacities at the Securities and Exchange Commission. He was an Assistant General Counsel and a Special Counsel in the Office of General Counsel and he was the Deputy Chief of the Office of Disclosure and Investment Adviser Regulation in the Division of Investment Management. Prior to working at the SEC, he was a litigator in the Bureau of Competition at the Federal Trade Commission. Mr. Price also worked as a Compliance Investigator at the Coffee, Sugar & Cocoa Exchange. He was an Adjunct Professor at Georgetown University Law Center from 1994 to 2002, where he taught "Current Issues in Securities Regulation" and "Disclosure under the Federal Securities Laws." He earned a degree in Economics from the University of Wisconsin and received his J.D. from Fordham University.

Panelists:

Brad Anderson is the Chief Compliance Officer at DFPG Investments, a small retail dual-registrant headquartered in Salt Lake City, UT. DFPG is known within the industry for expertise in alternative investments. Mr. Anderson is the co-founder of the SLC Compliance Roundtable and an advocate for professional development within the securities compliance industry. Mr. Anderson serves on the editorial board of the NSCP Publications Committee, in addition is FINRA's West Region District 3 representative. Over the course of his career including compliance and supervision roles at Fidelity and a tour in the United States Marine Corps. Mr. Anderson has taken what he has learned and applied to become a more effective compliance professional. In particular, Mr. Anderson has a keen appreciation for the human element in compliance.

Kelly Rock, Esq. has nearly 18 years in regulatory enforcement and brings expertise and powerful insight into complex financial products and emerging products and risk areas. Ms. Rock serves as Senior Counsel in CFI, the Complex Financial Instruments Unit of the Division of Enforcement, at the Securities and Exchange Commission. Ms. Rock has spent the past decade in CFI, investigating and recommending Enforcement actions related to, among others, TRS, RMBS, ETFs, ETNs, Leveraged Loans, Investment Adviser Funds, Pooled Investment Vehicles, Opportunity Zone Funds, and structured and complex products involving digital assets. Ms. Rock is an ongoing contributor to the Division of Enforcement's training program. She authored and presented on a variety of topics, both agency and division-wide, including leveraging technology and data analytics to support investigations, the use and implementation of Artificial Intelligence platforms, and the use of complex products and trading strategies. Mr. Rock has recommended dozens of Enforcement recommendations over her career, including maters arising from CFI's broader case initiatives involving RMBS and volatility linked ETPs. She has been named in numerous press and litigation releases. During her tenure at the SEC, in addition to Division Director's awards, Ms. Rock received the Enforcement Award for Excellence in Information Technology, and she was also commended with the SEC's Award for Community Service. Prior to joining the SEC, Ms. Rock was a commercial litigator with the law firm Milbank, Tweed, Hadley and McCloy. She graduated from the University of Texas School of Law with distinction, she has a masters from Columbia University, and is a proud alum of St. John's College in Annapolis, Maryland.

Thomas M. Selman, CFA is Founder of Scopus Financial Group, the premier source for customized research and professional services to asset management companies, broker-dealers, investment advisers, trade associations and other clients. Scopus develops a thorough understanding of each client's business and guides the client in a manner tailored to its needs. Before his retirement in 2020, Mr. Selman was Executive Vice President, Regulatory Policy, and Legal Compliance Officer of FINRA. He oversaw the departments of Corporate Financing and Advertising Regulation, the Office of Financial Innovation, and the Corporate Office of the General Counsel. Mr. Selman joined FINRA in 1996. Mr. Selman also holds the Chartered Financial Analyst® designation.

Alternative Investments and Complex Products

Panelists

- **Moderator**
  - Joseph Price, Senior Vice President, Corporate Financing & Advertising Regulation, FINRA Corporate Financing & Advertising Regulation
- **Panelists**
  - Brad Anderson, Chief Compliance Officer, DFPG Investments, LLC
  - Kelly Rock, Esq., Senior Counsel, Complex Financial Instruments Unit, U.S. Securities and Exchange Commission (SEC)
  - Thomas Selman, CFA, Founder, Scopus Financial Group

Alternative Investments and Complex Products
Monday, May 16, 2022
3:00 p.m. – 4:00 p.m.

Resources:

- FINRA *Regulatory Notice 22-08, FINRA Reminds Members of Their Sales Practice Obligations for Complex Products and Options and Solicits Comment on Effective Practices and Rule Enhancements* (March 2022)

  www.finra.org/rules-guidance/notices/22-08

- FINRA *Regulatory Notice 12-03, Heightened Supervision of Complex Products* (January 2012)

  www.finra.org/rules-guidance/notices/12-03

- NASD *Notice to Members 05-26, NASD Recommends Best Practices for Reviewing New Products* (April 2005)

  www.finra.org/rules-guidance/notices/05-26

Plenary Session IV: Keynote Address – Martina Edwards: Owning Greatness
Monday, May 16, 2022
4:15 p.m. – 5:15 p.m.

Martina Edwards may be a lot of things but quitting in the face of adversity has never been one of her attributes. In this motivational talk, Edwards will share her journey — from being raised in rural Alabama to breaking barriers on Wall Street and beyond. Join us as Martina connects the dots on the power of bold thinking, self-confidence, serving others and living up to your own greatness. She'll discuss the importance of Diversity, Equity and Inclusion (DEI) and how we can all actively participate in empowering people to create economic prosperity that transcends to others. Martina proves that hard work and smart financial moves, coupled with talent, are a recipe for success. It all starts by owning your greatness.

Introduction: Kayte Toczylowski
Vice President
FINRA Member Relations and Education

Speaker: Martina Edwards
Keynote Speaker

Plenary Session IV: Keynote Address – Martina Edwards: Owning Greatness Speaker Bios:

Introduction:

Kayte Toczylowski is Vice President of Member Relations and Education for FINRA. In leading the Member Relations and Education Department, Ms. Toczylowski's responsibilities include maintaining and enhancing open and effective dialog with FINRA member firms. Ms. Toczylowski also oversees FINRA's Member Education area, which includes FINRA conferences and other member firm educational offerings such as the FINRA Institute at Georgetown for the Certified Regulatory and Compliance Professional (CRCP)® designation. Ms. Toczylowski has been with FINRA since 2011 and spent nine years in Member Supervision's examination program. Most recently, Ms. Toczylowski was an Examination Director located in the Philadelphia, PA office, where she led geographically dispersed exam teams responsible for planning and executing Member Supervision's examination program relative to a subset of firms engaged primarily in Capital Markets & Investment Banking Services. She entered the securities industry in 2003 in the compliance department of Janney Montgomery Scott, a regional broker-dealer headquartered in Philadelphia. The majority of her eight-year career at Janney was spent as a compliance examiner for the firm's branch network. Ms. Toczylowski has a Bachelor of Arts degree in English from Villanova.

Speaker:

From humble Southern beginnings to breaking barriers on Wall Street, **Martina Marshall Edwards** is the epitome of refusing to allow your circumstances to dictate your outcome. A finance major and graduate of Alabama's Tuskegee University, a historically black college and university, Edwards went on to become the first African-American female equity trader for Merrill Lynch and in the 200-plus-year history of the New York Stock Exchange (NYSE). It also made her the only active African-American woman seat holder among its then 1,366 members. (Before the NYSE became public in 2006, individuals and companies had to either purchase or lease a seat to serve as a broker). In 2001, the NYSE was a dynamic, fast-paced, male-dominated environment with high-stakes trading activity, a steep learning curve and little to no room for error. It also was a place, despite many obstacles, where Edwards thrived. In 2004, after three years and two promotions, she earned a unique opportunity to become a member of the NYSE on behalf of Merrill Lynch. (It would take another 13 years before the second Black woman broker — Lauren Simmons — arrived.) Edwards is a walking example of how access can dramatically shift the trajectory of a career. Many have asked, "How did the little girl who grew up in a two-bedroom mobile home in rural Alabama with livestock in the backyard make it to the Big Apple, let alone the Big Board?" Known as the "Belle of Wall Street," Martina is an inspiring and dynamic speaker. From humble financial beginnings to reporting to the NYSE the week of 9/11, Martina is no stranger to adversity. She adamantly believes that every twist and turn ultimately molded and shaped her into the resilient individual and strong leader that she is today. Edwards knows that representation matters and staunchly believes in the importance of inspiring the next generation of leaders, particularly women. An investor by trade, a common thread has been her desire to build equity through access, opportunity and exposure for underserved people and places. Edwards has always wanted to step into roles that have an impact and leave an impression on people's lives. Her 20-year career journey has spanned multiple industries from public to private equity, non-profit leadership and venture capital. Through her rewarding work as a C-suite executive at Access to Capital for Entrepreneurs (ACE), Edwards is helping to level the playing field by giving business owners a chance when others can't or won't. Like homeownership, business ownership is an asset that supports closing a widening racial wealth gap, building financial stability through a ripple effect—a collective prosperity that goes beyond the immediate gain of an individual business owner. Raising over $25 million in grant funds in just under three years — including the largest individual and corporate gifts in ACE's history — finding ways to support traditionally underserved small business owners and entrepreneurs with capital, coaching and connections is core to her work. Martina has penned articles such as "The Fragility of Small Business" and been featured on CNN *Money*, CNBC *Make it Real*, PrivCap, WABE Radio, *The Atlanta Small Business Network* and in the *Atlanta Business Chronicle*.

Plenary Session IV: Keynote Address – Martina Edwards: Owning Greatness

Speakers

- **Introduction**
  - Kayte Toczylowski, Vice President, FINRA Member Relations and Education
- **Speaker**
  - Martina Edwards, Keynote Speaker