

# Chapman Client Alert

January 12, 2018

Current Issues Relevant to Our Clients

## FINRA 2018 Regulatory and Examination Priorities

The Financial Industry Regulatory Authority, Inc. (“FINRA”) recently issued its 2018 Regulatory and Examination Priorities Letter. A copy of the letter is available [here](#). A number of FINRA’s comments direct firms to review the 2017 Examination Findings Report, which is available [here](#), for additional insights into specific areas of concern and effective practices. Below are brief summaries of some of the more significant issues FINRA’s letter raises.

### Fraud

FINRA will continue to pursue investigations into fraudulent activities such as insider trading, microcap pump-and-dump schemes and Ponzi-type schemes. FINRA reminds firms to evaluate internal policies and training regarding permissible communications and interactions with microcap stock promoters to assist in avoiding fraudulent schemes. FINRA also called firms’ attention to new Rule 2165 with respect to protection of elderly investors.

### High-Risk Firms and Brokers

FINRA will continue to focus on firms’ hiring and supervisory practices for high-risk brokers, including remote supervision arrangements, supervision of point-of-sale activities and branch inspection programs as well as the risks that these firms and brokers may pose to investors. In addition, FINRA will continue to review firms’ controls regarding the outside business activities and private securities transactions of registered persons.

### Operational and Financial Risks

*Business Continuity Planning.* In light of 2017’s natural disasters, FINRA will review firms’ business continuity plans, including firms’ plans for restoring systems, procedures and records once they are prepared to return to normal business.

*Customer Protection and Verification of Assets and Liabilities.* FINRA will examine the accuracy of firms’ net capital and reserve computations. FINRA will review firms’ processes for verifying customer assets and whether firms have implemented adequate controls and supervision to protect customer assets. FINRA also stated that during the course of an exam, it may contact third parties, such as custodial banks, in order to assess the validity of reported positions.

*Technology Governance and Cybersecurity.* FINRA will continue to evaluate the effectiveness of firms’ cybersecurity programs to protect sensitive information from both external and internal threats. In addition, FINRA will evaluate firms’ information technology and change management policies to evaluate how technology changes may disrupt firms’ business operations.

*Anti-Money Laundering.* FINRA will assess the adequacy of firms’ anti-money laundering programs, including the adequacy of procedures to detect suspicious transactions, resources for AML monitoring and independent testing required under Rule 3310(c).

*Liquidity Risk.* FINRA will evaluate whether a firm’s liquidity planning is appropriate for the firm’s business and customers and whether it includes scenarios that are consistent with its collateral resources and client activity. In addition, FINRA will focus on the adequacy of firms’ material stress testing assumptions and effective practices as recommended in Regulatory Notice 15-33.

*Short Sales.* FINRA will examine firms’ policies and procedures for establishing and monitoring the rates charged to customers for short sales. FINRA will increase its focus on firms’ compliance with Rule 201 of Regulation SHO, which requires firms to develop policies and procedures regarding short sale orders when a short sale circuit breaker is in effect.

### Sales Practice Risks

*Suitability.* FINRA will continue to assess the adequacy of firms’ controls to meet their suitability obligations, including new product vetting and policies and procedures to educate personnel on product suitability, especially with respect to complex and higher risk products. FINRA will also focus on recommendations made to retirement plan participants and recommendations to switch from a brokerage account to an investment adviser account, which may have increased in 2017 in light of the Department of Labor’s proposed fiduciary rule.

*Initial Coin Offerings and Cryptocurrencies.* FINRA will closely monitor developments in the cryptocurrency space, including the role of firms and registered representatives in effecting transactions in cryptocurrencies.

*Use of Margin and Securities Backed Lines of Credit.* FINRA will assess firms' disclosure and supervisory practices related to margin loans. FINRA will review whether firms and registered persons adequately disclose the risk of margin loans and whether firms maintain controls reasonably designed to prevent excessive margin trading. FINRA will also focus on SBLOCs where the lender is an affiliate of the firm.

## Market Integrity

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*Manipulation.* FINRA will continue its efforts to protect the integrity of markets from manipulating activities. FINRA notes that a variety of recent enhancements have been made to its monitoring programs to increase accuracy and detect a broader range of manipulative activities, including activities conducted on or through alternative trading systems.

*Best Execution and Fixed Income Data.* FINRA is expanding its equity best execution surveillance program to assess the degree to which firms provide price improvement when routing customer orders for execution. FINRA also will review how firms manage the conflicts related to order routing inducements and has expanded its examinations to include transactions in Treasury securities.

*Options.* FINRA has developed new surveillance patterns to detect certain front running in correlated options products. FINRA will focus on options-related activity designed to impact the final national best bid or offer price and potential options-related violations of Securities Exchange Act Rule 14e-4 governing partial tender offers.

*Report Cards.* FINRA will launch several new report cards designed to assist firms with their compliance obligations, including the Auto Execution Manipulation Report Card, the Alternative Trading System Cross Manipulation Report Card and the Fixed Income Mark-up Report Card.

## New Rules

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The letter points out that a number of significant new and amended rules are currently scheduled to become effective or have compliance dates in 2018. FINRA recommends that firms review the steps they are taking to implement the obligations under these rules.

## Conclusion

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Firms should consider the FINRA areas of focus as they conduct their annual reviews of policies, procedures and business activities or when introducing a new product, business line or compliance tool to their existing business.

## For More Information

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If you would like to discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at [chapman.com](http://chapman.com).

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