

Chapman Client Alert

January 16, 2020

Current Issues Relevant to Our Clients

FINRA 2020 Risk Monitoring and Examination Priorities

The Financial Industry Regulatory Authority, Inc. (“FINRA”) recently issued its 2020 Risk Monitoring and Examination Priorities Letter. A copy of the letter is available [here](#). The letter also directs members to previous Risk Monitoring and Examination Priorities Letters available [here](#). The 2020 letter highlights the areas of focus for FINRA’s risk monitoring, surveillance and examination programs for 2020 and contain numerous links to Regulatory Notices, FINRA Reports and other resources to aid broker-dealers in complying with the priority areas. Firms should review their policies, procedures and business activities in light of FINRA’s letter.

Sales Practice and Supervision

Areas of continued focus include complex products, variable annuities, private placements, fixed income mark-up/mark-down disclosures, representatives acting in positions of trust or authority and senior investors.

Regulation Best Interest (“Reg BI”) and Form CRS will be a part of examinations throughout 2020. Prior to the June 30, 2020 compliance date, FINRA will review firm’s preparedness for Reg BI and to better understand challenges being faced by firms. After the compliance date, FINRA will review for compliance with Reg BI and implementation of Form CRS.

Communications with the public will continue to be assessed for compliance with FINRA Rules 2210 (Communications with the Public), 3110(b)(4) (Supervision) and 4510 (Books and Records Requirements) along with Securities Exchange Act of 1934 (“Exchange Act”) Rules 17a-3 and 17a-4 (Books and Records Requirements). Additionally, FINRA will focus on:

- **Private placement communication** with an emphasis on how firms’ review, approve, supervise and distribute retail communications regarding private placement securities via online distribution platforms in addition to traditional channels; and
- **Communications via digital channels** (e.g., texting, messaging, social media or collaboration applications).

Bank sweep programs and other cash management services will be evaluated for firms’ compliance with a range of FINRA and SEC rules despite FINRA’s recognition of the useful features of the programs for many customers. FINRA laid out eight factors that it will consider when reviewing cash sweep programs including two factors addressing firms’ disclosure of the arrangements to clients.

Sales of initial public offering shares will be examined for firms’ attention to their obligations under FINRA Rules 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and 5131 (New Issue Allocations and Distributions).

Trading authorization procedures and controls will be assessed for whether firms maintain reasonably designed supervisory systems relating to trade authorization, discretionary account supervision of registered representatives and key transaction descriptors such as solicited versus unsolicited trades.

Market Integrity

Areas of continued focus include market manipulation, Trade Reporting and Compliance Engine (“TRACE”) reporting, short sales and short tenders. Reporting accuracy in Order Audit Trail System (“OATS”) reporting continues to be a priority for FINRA along with reporting to the Consolidated Audit Trail (“CAT”) that will begin for some firms in April 2020.

Direct market access controls will be emphasized to ensure firms are complying with Exchange Act Rule 15c3-5 (Market Access Rule) focusing on issues relevant to firms’ business activities and associated risks.

Best execution practices will continue to be reviewed by FINRA with a focus on:

- Review of potential conflicts in order routing decisions including the impact of recent increases in zero-commission brokerage activity;
- Odd-lot handling;
- Reasonableness of firms’ policies and procedures for best execution and fair pricing for U.S. Treasury securities; and

- Option order execution pricing.

Disclosure of order routing information reviewed by FINRA for compliance with Regulation National Market System (“NMS”) Rule 606.

Vendor Display Rule data capture and reporting in compliance with Rule 603 of Regulation NMS will be a focus item for FINRA with an emphasis on adequacy of firms’ controls and supervisory systems to provide their customers with the current consolidated national best bid and offer.

Financial Management

Areas of continued focus include firms’ compliance with Exchange Act Rule 15c3-3 (Customer Protection Rule) and Exchange Act Rule 15c3-1 (Net Capital Rule) as well as firms’ overall financial risk management programs.

Digital assets raise novel and complex regulatory issues and FINRA will work closely with the SEC to understand firms’ usage of and involvement with digital assets, corresponding compliance with applicable laws and whether a firm has filed a Continuing Membership Application to cover the activity.

Liquidity management practices remain a critical firm control function and FINRA will continue to focus on areas addressed in FINRA Regulatory Notice 15-33 (Guidance on Liquidity Risk Management Practice).

Underwriting activities will be reviewed for compliance with Exchange Act Rule 15c3-1(c)(2)(viii), including firm processes to assess moment-to-moment and open contractual commitment capital charges.

London Interbank Offered Rate (LIBOR) transitions will be an area of engagement by FINRA although outside of the examination program.

Firm Operations

Areas of continued focus include supervisory controls relating to Exchange Act Rule 10b-10 and FINRA Rule 2232 (Customer Confirmations) and firms’ compliance with FINRA Rule 3310 (Anti-Money Laundering Compliance Program).

Cybersecurity controls, policies and procedures will be assessed by FINRA to determine whether they are reasonably designed to protect customer records and information consistent with Regulation S-P Rule 30.

Technology governance will be evaluated by FINRA to ensure that firms’ increasing reliance on technology for customer-facing activities, trading, operations, back-office and compliance are not inappropriately exposing firms to operational failures that may compromise their ability to comply with rules and regulations including, but not limited to, FINRA Rules 4370 (Business Continuity Plans and Emergency Contact Information), 3110 (Supervision) and 4511 (General Requirements) and Exchange Act Rules 17a-3 and 17a-4.

Conclusion

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

For More Information

If you would like further information concerning the matters discussed in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

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