FINRA®

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2025 FINRA Annual Regulatory Oversight Report

Contents

Introduction

The 2025 FINRA Annual Regulatory Oversight Report (the Report) provides FINRA member firms (firms) with insight into findings from FINRA's regulatory operations programs. The Report reflects FINRA's commitment to providing transparency to firms and the public about our regulatory observations and activities.

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 prior Reports by adding new topics denoted **NEW FOR 2025** and new material (*e.g.,* new findings, effective practices) to existing sections where appropriate. (New material is in **bold** type.)

This year's Report addresses a broad range of content, including new topic areas dedicated to:

- third-party risk landscape;
- registered index-linked annuities; and
- extended hours trading.

Additionally, the Report highlights new content on various topics denoted in blue "callout" boxes, including updates on:

- artificial intelligence (AI);
- investment fraud by bad actors that directly targets investors;
- FINRA rules concerning the Remote Inspections Pilot Program and Residential Supervisory Location designation; and
- trade reporting enhancements for fractional share transactions.

Please note that the removal of a topic or content from this year's Report does not indicate that the topic is not of regulatory importance, and you may continue to review those topics and content in the previous Reports as well as other guidance and tools available on FINRA.org.

Additionally, for each topic area, the Report continues to:

- identify the relevant rule(s);
- summarize noteworthy findings or observations from recent oversight activities;
- outline effective practices that FINRA observed through our oversight activities; and
- provide additional resources that may be helpful to firms in reviewing their supervisory procedures and controls and fulfilling their compliance obligations.

FINRA welcomes feedback on how we can improve future publications of this Report. Please contact the Office of Strategic Engagement to provide recommendations.

How to Use This Report

We selected the topics in this Report for their interest to the largest number of firms; consequently, they may include areas that are not relevant to an individual firm and omit other areas that are applicable.

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

FINRA also reminds firms to stay apprised of new or amended laws, rules and regulations, and update their written supervisory procedures (WSPs) and compliance programs in response. Firms may contact their Risk Monitoring Analyst if they have any questions about the observations, findings or effective practices included in this Report.

The Report contains the following for each topic area:

- **Regulatory Obligations**—A brief description of relevant federal securities laws, regulations and FINRA rules.
- **Effective Practices**—Select effective practices, including those that FINRA has observed through our oversight activities, which may help firms in tailoring their compliance programs depending on their business model, size and practice.
- **Additional Resources**—A list of relevant FINRA *Regulatory Notices*, other reports, tools and online resources.

Additionally, as applicable, the topic areas in the Report may contain information on:

- **Findings**—Information from recent reviews, examinations, market surveillance, investigations or enforcement activities; or findings we highlighted in prior Reports and that we continue to note in recent oversight activities.
- **Observations**—Items that are observed weaknesses in firm compliance programs that could benefit from review and additional enhancements.
- **Emerging and Continuing Trends and Risks**—Potential concerns due to an evolving landscape that may pose new or additional risk for customers and firms.

The Report also includes an Appendix that outlines how firms have used similar FINRA reports *(e.g.,* Findings Reports, Priorities Letters) in their compliance programs.

As a reminder, the Report—as with our previous Exam and Risk Monitoring Reports, Findings Reports and Priorities Letters—does not create any new legal or regulatory requirements or new interpretations of existing requirements, or relieve firms of any existing obligations under federal securities laws and regulations. *You should not infer that FINRA requires firms to implement any specific practices described in this Report that extend beyond the requirements of existing federal securities provisions or FINRA rules.* Rather, firms may consider the information in this Report in developing new, or modifying existing, compliance practices. Moreover, some content may not be relevant to individual firms based on their business models, size or practices.

Financial Crimes Prevention

Cybersecurity and Cyber-Enabled Fraud

Regulatory Obligations

Cybersecurity incidents, such as account takeovers, ransomware or network intrusions, and any related exposure of customer information or fraudulent financial activity can expose firms to loss of customer information, financial losses, reputational risks and operational failures that may compromise firms' ability to comply with a range of rules and regulations, including FINRA Rules 4370 (Business Continuity Plans and Emergency Contact Information) and 3110 (Supervision), as well as Securities Exchange Act (SEA) Rules 17a-3 and 17a-4, Regulation S-P and Regulation S-ID.

Such incidents could also implicate FINRA Rule 4530(b) (Reporting Requirements), which require firms to promptly report to FINRA when they have concluded (or reasonably should have concluded) that they or their associated person have violated any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body or self-regulatory organization, where such violative conduct meets the standards in FINRA Rules 4530.01 (Reporting of Firms' Conclusions of Violations) **and 3310 (Anti-Money Laundering Compliance Program).**

Observations and Effective Practices

Observations

FINRA has observed an increase in the variety, frequency and sophistication of certain cybersecurity **attacks and** incidents **that represent threats to the financial industry, including:**

- **Ransomware**—cyberattacks where threat actors gain unauthorized access to firm systems, encrypting or otherwise accessing sensitive firm data or customer information, and then holding that hijacked data or customer information for ransom;
- **New Account Fraud—threat actors using falsified customer information or stolen identity information purchased from criminal sites on the dark web to open accounts at financial institutions using a mobile app or internet browser;**
- **Insider Threats**—incidents where firm employees, advertently or inadvertently, use their access to firms' systems and data to cause harm to firms, their customers or both;
- **Account Takeovers—threat actors using compromised investor information (*e.g.*, login credentials, such as usernames and passwords) to gain unauthorized access to online accounts;**
- **Data Breaches—attacks in which threat actors obtain access to confidential information (*e.g.*, firm data, clients' personally identifiable information (PII)) through an attack, and then expose, or threaten to expose, this information across the clear and dark nets;**
- **Imposter Sites—attacks in which threat actors leverage imposter sites, domains and social media profiles for cyber-enabled fraud (including those that impersonate financial firms, registered representatives and FINRA staff); and**
- **Quishing—compromise attacks that use QR codes to redirect victims to phishing URLs.**

Third-party vendors can pose additional cyber threats to firms by introducing vulnerabilities that can lead to data breaches and supply chain attacks. For additional guidance, please see the Third-Party Risk Landscape topic.

FINRA has also observed these emerging threats that may impact firms:

- **Quasi-Advanced Persistent Threats (Quasi-APTs)—well-resourced threat actors that engage in sophisticated, malicious cyber activity targeted and aimed at prolonged network or system intrusion (*i.e.*, APTs), but are not necessarily sponsored by nation states or large organizations.**
- **Generative AI (Gen AI)-Enabled Fraud[1]—threat actors exploiting generative AI's ease of use and wide range of applications to enhance their cyber-enabled crimes, for example, by:**
  - **generating fake content (*e.g.*, imposter sites, false identification documents, deepfake audio and video);**
  - **creating polymorphic malware—a type of malicious software that constantly morphs, evolves or changes appearance to avoid detection by security products; and**
  - **leveraging generative AI models to develop malicious tools, allowing those without technical ability to become sophisticated cybercriminals.**
- **Cybercrime-as-a-Service—criminals with technical expertise selling tools and services to less technical threat actors, allowing them to commit cybercrimes they would not have otherwise been able to conduct (particularly ransomware, under the Ransomware-as-a-Service model).**

For additional guidance concerning threat actors' manipulation of generative AI to commit cyber-enabled fraud, please see the Emerging Risk: Adversarial Use of Generative Artificial Intelligence "callout" box in the Anti-Money Laundering, Fraud and Sanctions topic.

Effective Practices

- **Account Intrusion:** Reviewing potentially violative activity when identified to determine whether further action (*e.g.,* trading and fund restrictions on the accounts) is appropriate.
- **Imposter Domains:** Monitoring the internet for any new imposter domains that pretend to represent the firm or a registered representative; and maintaining written procedures for responding to reports of imposter domains that include reporting the domains and notifying impacted customers or business partners.
- **Outbound Email Monitoring:** Implementing systems that scan outbound email and attachments to identify and potentially block sensitive customer information or confidential firm data.
- **Potential Intrusion Report Card:** Leveraging the FINRA Cross Market Options Supervision: Potential Intrusion Report Card, which provides lists of trades related to potentially fraudulent options transactions facilitated by account takeover schemes.
- **Training and Security Awareness:** Periodically training staff to identify and thwart tactics, techniques and procedures (TTPs) associated with people-centric attack vectors (*e.g.*, phishing attacks, social engineering).
- **Identity Verification:** For firms that allow new accounts to be opened online, developing a comprehensive process for validating the identity of new clients; and using third parties that can verify identities and provide a score related to the level of risk associated with a new account (to help firms determine if additional verification is required).
- **Tabletop Exercise (TTX)**: **Regularly conducting a TTX to bring key internal and external stakeholders together and ensure current and emerging cyber and technology threats and risks are appropriately identified, mitigated and managed.**
- **Lateral Movement: Subdividing networks into separate sections (*i.e.,* segment networks) to restrict the ability of threat actors to move across networks to find valuable data.**

Additional Resources

- FINRA
  - **2025 Report—Third-Party Risk Landscape**
  - **2024 Cybersecurity Conference**
  - Cybersecurity Key Topics Page, including:
    - Small Firm Cybersecurity Checklist (September 7, 2023)
    - Core Cybersecurity Threats and Effective Controls for Small Firms (May 5, 2022)
- SEC
  - **SEC Charges Three Individuals with Impersonating Financial Professionals in Fraud Scheme Targeting Retail Investors (December 11, 2024)**
  - SEC Proposes to Expand and Update Regulation SCI (March 15, 2023)
  - SEC Proposes New Requirements to Address Cybersecurity Risks to the U.S. Securities Markets (March 15, 2023)
- CISA
  - CISA Tabletop Exercise Packages
  - Free Cybersecurity Services and Tools
  - **Stop Ransomware**

Quantum Computing Risks

Quantum computing is an emerging technology that relies on quantum mechanics to perform calculations not possible for the most powerful classical supercomputers:

- Several financial institutions, including broker-dealers, have started exploring how leveraging quantum for exponential improvements in computing performance could enhance business operations (*e.g.*, optimization systems for trade execution and settlement; simulations of market-related activity).
- However, as with all technology, quantum computing could be exploited by threat actors to aggravate the risk of cybersecurity-related crimes. In particular, quantum computers may eventually have the ability to quickly break current encryption standards firms and others in the financial services industry currently use.
- Firms considering whether to incorporate quantum computers into their internal systems and processes, as well as firms contemplating the potential threats the use of quantum computing may raise, may consider putting particular focus on regulatory issues such as cybersecurity, third-party vendor management, data governance and supervision.

For additional guidance, please see:

- FINRA—Quantum Computing and the Implications for the Securities Industry
- Cybersecurity and Infrastructure Security Agency (CISA)—Post-Quantum Cryptography Initiative
- National Institute of Standards and Technology (NIST)—Post-Quantum Cryptography
- National Security Agency (NSA), CISA, NIST—Quantum-Readiness: Migration to Post-Quantum Cryptography

Anti-Money Laundering, Fraud and Sanctions

Regulatory Obligations

FINRA Rule 3310 (Anti-Money Laundering Compliance Program) requires that each firm develop and implement a written anti-money laundering (AML) program that is approved in writing by senior management and is reasonably designed to achieve and monitor the firm's compliance with the Bank Secrecy Act (BSA) and its implementing regulations.[2] FINRA Rule 3310(a) requires that firms establish and implement AML policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions;[3] FINRA Rule 3310(c) requires that the AML program provide for independent testing for compliance each calendar year (or every two calendar years in some specialized cases); FINRA Rule 3310(e) requires that the program provide ongoing training for appropriate personnel; and FINRA Rule 3310(f) requires that firms' AML programs include appropriate risk-based procedures for conducting ongoing customer due diligence (CDD).

Other requirements contained in the BSA's implementing regulations include maintaining a Customer Identification Program (CIP); verifying the identity of the beneficial owners of legal entity customers; 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.[4]

Investment Fraud by Bad Actors Targeting Investors Directly

FINRA has observed an increase and evolution in investment fraud committed by bad actors who engage directly with investors. This typically includes enticing victims to withdraw funds from their securities accounts and send the funds to the bad actors as part of a fraudulent scheme.

- According to the most recent FBI Internet Crime Report, investment fraud is the costliest type of crime tracked by the FBI's Internet Crime Complaint Center (IC3), with complaints and losses regarding related scams continuing to rapidly increase.
- Common types of investment fraud include:
  - **Investment Club Scams**: schemes in which bad actors post fraudulent social media advertisements—often using the likeness of well-known finance personalities unaffiliated with the scam—to direct victims to purported "investment clubs" on encrypted messaging applications, where victims are persuaded to purchase shares of low-volume and thinly traded securities.
  - **Relationship Investment Scams:** schemes in which fraudsters often hide their true identities and reach out to unsuspecting targets (often online or through text messages), gain the victim's trust over time, and then defraud them through fake investments. These schemes are sometimes referred to by terms such as "romance scams," "cryptocurrency investment scams" and "financial grooming scams."
  - **Imposter Websites:** schemes in which malicious actors use names and other legitimate information to establish a web presence that purports to be a broker-dealer firm, registered representative, financial regulator or law enforcement agency.
  - **Tech Support and Support Center Scams**: schemes in which bad actors impersonate firms' customer support centers through online sponsored advertising, with the goal to misdirect victims and steal funds, PII or both.

Firms may consider using the following effective practices to help mitigate these threats:

- monitoring for abrupt changes in customer behavior, such as a customer making a withdrawal request that does not align with the customer's typical behavior (*e.g.*, smaller withdrawals over a long period of time, or one or more sudden large withdrawals);

- educating firm personnel who are in direct contact with customers how to recognize red flags, how to communicate with customers that they may suspect are victims and how to escalate concerns;
- relying on FINRA Rule 2165 (Financial Exploitation of Specified Adults) to place a temporary hold on a customer's securities transactions or disbursements where there is a reasonable belief of customer financial exploitation;[5]
- emphasizing the importance of trusted contact persons and promoting effective practices in connection with FINRA Rule 4512 (Customer Account Information);[6]
- providing educational material to customers explaining how scams occur and providing resources for victimized customers (including those on FINRA's For Investors page); and
- developing response plans for situations where the firm identifies that a customer has been victimized, including:
  - notifying a customer's trusted contact person of any concerns;
  - for elder or vulnerable adults, notifying Adult Protective Services;
  - in addition to filing required suspicious activity reports (SARs), reporting the fraud to the appropriate regulatory (*e.g.*, FTC, SEC, FINRA) and law enforcement agencies (*e.g.*, FBI, the customer's state's Attorney General's Consumer Protection Office and Crime Victim Coalition); and
  - engaging with the FBI's IC3 Recovery Asset Team via their Internet Crime Complaint Center to attempt to recall outgoing wire transactions.

For additional guidance concerning external fraud identification, mitigation and prevention, please see:

- The Senior Investors and Trusted Contact Persons topic in the 2025 Report
- FINRA Securities Helpline for Seniors
- FINRA Investor Alert: Relationship Investment Scams (September 10, 2024)
- FINRA Threat Intelligence Product: Protecting Vulnerable Adult and Senior Investors (May 2024)
- FINRA Foundation's Taking Action: An Advocate's Guide to Assisting Victims of Financial Fraud (2021)
- *Regulatory Notice 20-30* (Fraudsters Using Registered Representatives Names to Establish Imposter Websites)

Findings and Effective Practices

Findings

- **Misconstruing Obligation to Conduct CIP and CDD:** Not recognizing that certain formal relationships established with the firm to effect securities transactions are customer relationships (and, consequently, not conducting CIP or CDD as required).
- **Unreasonable Procedures Concerning CIP and CDD: Not establishing and implementing reasonably clear and detailed policies and procedures concerning CIP and CDD requirements.**
- **Inadequate Verification of Customer Identities:** Not collecting identifying information at the time of account opening, not reasonably verifying the identity of customers and beneficial owners of legal entity customers with documentary or non-documentary methods within a reasonable timeframe, **or, when suspicious activity is detected, not reevaluating the information provided during the customer onboarding and customer identification process as appropriate**.
- **Inadequate Responses to Red Flags:**
  - Auto-approving customer accounts despite red flags, or otherwise not performing a reasonable review of potential red flags associated with verifying customer identities (*e.g.*, applicant provided a Social Security number that was not valid or was associated with the name of a different person, including a deceased individual).

- **Not escalating customer accounts notwithstanding indicia that they are nominee accounts, which have been used to invest in IPOs and then engage in pump-and-dump-like schemes, as highlighted in *Regulatory Notice* 22-25 (Heightened Threat of Fraud).**
- Failing to establish policies and procedures that can be reasonably expected to detect identity theft or synthetic identity fraud in connection with account opening (*e.g.*, PII does not match a consumer report or was used on another account the firm knew was fraudulent).

- **Inadequate Due Diligence:** Not conducting initial and ongoing risk-based CDD to understand the nature and purpose of customer relationships to develop a customer risk profile, or conduct **the required** due diligence on correspondent accounts **the firm maintains for** foreign financial institutions.
- **Inadequate Ongoing Monitoring of Suspicious Transactions:**
  - Not establishing and implementing written AML procedures that can reasonably be expected to detect and cause the reporting of suspicious **transactions**.
  - **Not devoting sufficient resources to suspicious activity monitoring programs, including following a business expansion or a material increase or change in transactions.**
  - Not reasonably reviewing for and responding to red flags**, including for patterns of activity**, associated with:
    - orders and securities trading;
    - the movement or settlement of cash or securities (*e.g.*, wire and Automated Clearing House (ACH) transfers, debit card and ATM transactions, securities trading (including order entry), journal transfers);
    - **the origin and destination locations (*i.e.*, high-risk jurisdictions) of transfers;**
    - **transfers made to or from unrelated third parties;**
    - the firm's business operations including activity related to high-risk products and services (*e.g.*, cash management products and services; trading of low-priced and thinly traded securities); and
    - suspicious activity introduced to the firm by other firms.
- **Inadequate Ongoing Reporting of Suspicious Transactions:**
  - Not notifying the AML department of events that may require the reporting of a SAR, including cybersecurity events, account compromise or takeovers, or fraudulent wire or ACH transfers.
  - Not reasonably investigating inquiries from law enforcement, clearing firms, regulators or other federal and state agencies that concern red flags of suspicious activity.
  - Not reviewing and responding to information requests from FinCEN issued pursuant to Section 314(a) of the Patriot Act,[7] or not doing so within the required two-week timeframe.
- **Inadequate Testing:** Not conducting adequate independent testing of their AML program by:
  - not providing for annual testing of the program on a calendar year basis (or every two calendar years in specialized circumstances);
  - not testing critical aspects of the AML program for reasonableness (*e.g.*, suspicious activity detection and reporting), including where firms have taken on new products, services or client bases that may have materially shifted the firm's AML risk profile or situations where new threats to the industry are applicable to the firm;
  - conducting testing that is not reasonably designed, such as testing that fails to consider whether AML reports and systems are accurately and reasonably capturing suspicious transactions and are reasonably tailored to the AML risks of the firm's business; and
  - not confirming that persons with the requisite independence and qualifications perform the testing.

- **Inadequate Training: Not providing adequate training for appropriate personnel (*e.g.*, training fails to address how to identify red flags of suspicious transactions or actions to take in response to red flags that are detected).**

Continuing Risk: ACH Fraud

FINRA has recently observed an increase in suspicious and fraudulent activity related to ACH fraud. This observation is consistent with recent findings and rulemaking activity from other organizations:

- According to FinCEN, ACH fraud was the most reported suspicious activity in securities and futures SAR filings between 2014 and 2022.[8]
- On October 1, 2024, the National Automated Clearinghouse Association (Nacha) issued new requirements that all non-consumer participants in the ACH network implement fraud detection and monitoring programs.
- ACH fraud encompasses two fraud typologies:
  - **First-party ACH fraud:** A customer initiates a fraudulent ACH reclaim without sufficient funds, which typically comes in two forms:
    - Non-sufficient funds fraud (NSF)—taking advantage of the "instant funds credit" firms offer to customers that initiate ACH pulls into a brokerage account, which makes some or all the funds requested immediately available to the customer even though the funds have not settled in the account and there are no funds in the customer's account; and
    - Unauthorized reclaim fraud (URF)—reporting a false claim of third-party fraud within the ACH system's 60-day reporting window, triggering the funds sent via ACH transfer to be "recalled" from the receiving account.
  - **Third-party ACH fraud:** A bad actor conducts a fraudulent ACH transaction by using stolen or synthetic information to:
    - take over a legitimate customer account at a depository financial institution (*i.e.*, an account takeover); and
    - open a brokerage account in the name of the legitimate customer (*i.e.*, new account fraud).
    - The bad actor then submits an ACH transfer request to:
      - pull assets from the legitimate customer's compromised account at a depository financial institution; and
      - deposit them into the brokerage account fraudulently established in the legitimate customer's name.[9]
- The increase in ACH fraud may stem from bad actors' preference to use ACH over wire transactions, since the ACH system can more easily, quickly and cheaply move funds between accounts.

Some effective practices for firms to consider to help mitigate vulnerability to this type of fraud, especially those firms that offer fully online account opening services and rely on automated account opening or customer verification services, are to:

- require additional identification and verification documents during account opening and initiation of ACH transfer requests, such as obtaining customer account statements from the originating depository financial institution (ODFI) prior to processing an ACH transaction;
- implement internal procedures using Nacha's recommended cutoff times for the same-day ACH function (which allows the financial institution to be notified more quickly of any issues with an ACH transaction, such as insufficient funds);

- use micro-deposits, test deposits or test transactions as micro-entries to verify the connection to a customer's bank account for funds transfer;
- contract with third-party vendors that offer services to risk rank customers attempting to deposit funds in an account at a financial institution based on real time assessment of whether the account is open and in good standing, along with previous activity related to that account;
- communicate known fraud scenarios, red flags, fake identities and electronic identifying information (*e.g.*, IP addresses) to organizations such as the National Cyber-Forensics and Training Alliance (NCFTA), Early Warning Services (EWS) and InfraGard; and
- limit the amount and number of outbound transfers from a brokerage account to help mitigate first-party ACH fraud, based on factors such as specific time periods, the age of an account or other potential red flags that could indicate the account is at risk for certain type of fraud.

For additional guidance, FINRA recommends:

- *Regulatory Notice 21-14* (FINRA Alerts Firms to Recent Increase in ACH "Instant Funds" Abuse); and
- Nacha's ACH Operations Bulletin #1-2023 Update to Sample Written Statement of Unauthorized Debit.

Effective Practices

- **Investigating Unusual Withdrawal Requests: Conducting thorough inquiries when customers—particularly those who may be elderly or vulnerable—request that an unusually significant amount of funds be disbursed to a personal bank account, including where the disbursements would incur losses, fees or negative tax consequences (*e.g.*, a disbursement from a retirement account), as these could be signs of affinity fraud, relationship fraud, Ponzi schemes or other forms of misappropriation.**
- **Reviewing Clearing Firm Transactions: Reviewing transactions on a firm-by-firm basis to identify patterns of potentially suspicious transactions.**
- **Reviewing Regulatory Updates:** Reviewing alerts, advisories, significant cases and other updates from the SEC, FinCEN, FINRA, OFAC, and other regulators and agencies; **and incorporating the** information from such **updates into the firm's AML systems and procedures,** as appropriate**.**
- **Conducting Risk Assessments:**
  - Conducting formal, written AML risk assessments that are updated in appropriate situations, such as:
    - following the findings of its independent AML test or other internal or external audits;
    - changes in the size or risk profile of the firm (*e.g.*, changes to business lines, products and services, registered representatives, customers or geographic areas in which the firm operates); or
    - material macroeconomic or geopolitical events.
  - **For firms that engage in low-priced securities or small capitalization initial public offerings, ensuring that your firm's reasonably designed AML procedures detect and respond to red flags associated with that activity, including those detailed in:**
    - *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); and
    - ***Regulatory Notice 22-25* (Heightened Threat of Fraud).**
  - **Reviewing alerts or exception reports to ensure they are functioning as intended and that the firm's surveillance systems properly ingest the required data.**
  - **Ensuring the firm's AML procedures are tailored to services your firm provides, including services such as direct market access or access to alternative trading systems.**

- **Additional Steps for Verifying Customers' Identities When Establishing Online Accounts:** Incorporating additional methods for verifying customer identities as part of the firm's CIP through, for example:
  - requiring both documentary (*e.g.,* driver licenses, **government-issued IDs**) and non-documentary identifying information, or multiple forms of documentary information;
  - asking follow-up questions or requesting additional documents based on information from credit bureaus, credit reporting agencies or digital identity intelligence (*e.g.*, automobile and home purchases);
  - contracting third-party vendors to help verify the legitimacy of suspicious information in customer applications (*e.g.*, cross-referencing information across multiple third-party vendors);
  - validating identifying information that applicants provide through likeness checks;[10]
  - reviewing the IP address or other available geolocation data associated with:
    - new online account applications for consistency with the customer's home address; and
    - transfer requests (for consistency with locations from which the firm has previously received legitimate customer communications);
  - obtaining a copy of the account statement from the account slated to be transferred before sending an Automated Customer Account Transfer Service (ACATS) request;
  - for firms that initiate ACATS transfers (*i.e.*, delivering firms), sending notifications to account owners (*e.g.*, "push" notifications on mobile apps, emails, phone calls) or contacting any broker(s) assigned to the account or both;
  - ensuring that any tools used for automated customer verification are reasonably designed to detect red flags of identity theft and synthetic identity fraud;
  - limiting automated approval of multiple accounts for a single customer;
  - reviewing account applications for common identifiers (*e.g.,* email address, phone number, physical address) present in other applications and in existing accounts, especially seemingly unrelated accounts; and
  - reviewing account applications for use of temporary or fictitious email addresses (*e.g.,* @temporaryemail.org) or phone numbers (*e.g.,* 555-555-5555, 999-999-9999).
- **Delegation and Communication of AML Responsibilities:** Delegating AML duties to business units in the best position to conduct ongoing monitoring to identify suspicious activity; and establishing written escalation procedures and recurring cross-department communication between AML, compliance and relevant business unit(s).
- **Training:** Establishing and maintaining an AML training program for appropriate personnel that is tailored to the individuals' roles and responsibilities, addresses industry developments impacting AML risk and regulatory developments, and, where applicable, leverages trends and findings from the firm's quality assurance controls and independent AML test.

Emerging Risk: Adversarial Use of Generative Artificial Intelligence

FINRA has observed that bad actors are increasingly exploiting generative artificial intelligence (Gen AI) in ways that amplify threats to investors, firms and the securities markets:

- **Investment Club Scams:** creating text, as well as deepfake[11] audio and video, to impersonate well-known finance personalities in fraudulent social media advertisements for purported investment clubs hosted on end-to-end encrypted messaging applications.
- **New Account Fraud and Account Takeovers:** creating synthetic IDs, deepfake media (*e.g.*, a photo of a Gen AI–created person holding a Gen AI–created ID) and malware to establish new fraudulent brokerage accounts, or take over customers' brokerage accounts to conduct financial crimes (*e.g.*, theft of funds, fraudulent ACATS transfer requests, manipulative trading, instant funds abuse).
- **Business Email Compromise:** using Gen AI-enhanced social-engineering schemes to compromise firm email accounts (*e.g.*, tailoring the text in phishing emails to appear to be written for each individual target) to trick employees into conducting fraudulent wire transfers.
- **Ransomware Attacks:** conducting phishing campaigns with Gen AI-enhanced digital media (*e.g.,* fake emails, text, and phone and video calls that appear realistic) and using Gen AI–enhanced malware to gain unauthorized access to a firm's network, lock or exfiltrate sensitive information and extort money.
- **Imposter Scams:** creating websites that impersonate firms and associated persons to lure victims into investing funds with fraudulent entities.
- **Market Manipulation:** using Gen AI–created images or deepfake videos to spread false information on social media to move a company's stock price in a direction from which the bad actors have prepositioned themselves to benefit.

Firms may consider communicating with their employees and customers about the heightened risks related to Gen AI and steps the employees and customers can take to mitigate these threats.

For additional information, FINRA recommends these *Investor Insights* articles:

- Investor Alert: Relationship Investment Scams (September 10, 2024)
- Be Aware of Support Center Ad Scams (July 25, 2024)
- Be Alert to Signs of Imposter Investment Scams (March 11, 2024)
- Artificial Intelligence (AI) and Investment Fraud (January 25, 2024)
- Following the Crowd: Investing and Social Media (March 13, 2023)

Additional Resources

- FINRA
  - Anti-Money Laundering (AML) Key Topics Page
  - Anti-Money Laundering (AML) Template for Small Firms (September 8, 2020)
  - Frequently Asked Questions (FAQ) regarding Anti-Money Laundering (AML)
  - Industry Risks and Threats—Resources for Member Firms
  - Identity Theft Red Flags Rule Template
- SEC
  - **Staff Bulletin: Risks Associated with Omnibus Accounts Transacting in Low-Priced Securities (October 17, 2023)**
  - **Risk Alert: Observations from Anti-Money Laundering Compliance Examinations of Broker-Dealers** (July 31, 2023)

- **Risk Alert: Observations from Broker-Dealer and Investment Adviser Compliance Examinations Related to Prevention of Identity Theft Under Regulation S-ID** (December 5, 2022)
- Anti-Money Laundering (AML) Source Tool for Broker-Dealers (May 16, 2022)
- Risk Alert: Compliance Issues Related to Suspicious Activity Monitoring and Reporting at Broker-Dealers (March 29, 2021)

▶ Treasury and FinCEN

- **FinCEN Alerts/Advisories/Notices/Bulletins/Fact Sheets, including:**
  - **FinCEN Alert on Fraud Schemes Involving Deepfake Media Targeting Financial Institutions** (November 13, 2024)
  - **FinCEN Notice on the Use of Counterfeit U.S. Passport Cards to Perpetrate Identity Theft and Fraud Schemes at Financial Institutions** (April 15, 2024)
  - **FinCEN Alert to Financial Institutions to Counter Financing to Hamas and its Terrorist Activities** (October 20, 2023)
  - **FinCEN Alert on Prevalent Virtual Currency Investment Scam Commonly Known as "Pig Butchering"** (September 8, 2023)
- The Anti-Money Laundering Act of 2020 (June 30, 2021)
- Anti-Money Laundering and Countering the Financing of Terrorism National Priorities (June 30, 2021)

▶ Financial Action Task Force

- Risk-based Approach Guidance for the Securities Sector (October 26, 2018)

Manipulative Trading

Regulatory Obligations

Several FINRA rules prohibit firms from engaging in impermissible trading practices, including manipulative trading—for example, FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices), 5210 (Publication of Transactions and Quotations), 5220 (Offers at Stated Prices), 5230 (Payments Involving Publications that Influence the Market Price of a Security), 5240 (Anti-Intimidation/Coordination), 5270 (Front Running of Block Transactions), 5290 (Order Entry and Execution Practices) and 6140 (Other Trading Practices).

Under FINRA Rule 3110 (Supervision), firms are required to include in their supervisory procedures a process to review securities transactions that is reasonably designed to identify trades that may violate the provisions of the Exchange Act, the rules thereunder, or FINRA rules prohibiting insider trading and manipulative and deceptive devices that are effected for accounts of the firm and its associated persons. The firm must conduct promptly an internal investigation into any such trade to determine whether a violation of those laws or rules has occurred.

Among other obligations, FINRA Rule 5210 prohibits firms from publishing or circulating communications regarding transactions and quotations unless they believe the information is bona fide; FINRA Rule 5270 prohibits trading in a security **or related financial instrument** that is the subject of an imminent customer block transaction while in possession of material, nonpublic market information concerning that transaction; and FINRA Rule 6140 contains several requirements to ensure the promptness, accuracy, and completeness of last sale information for National Market System (NMS) stocks and to prevent that information from being publicly trade reported in a fraudulent or manipulative manner.

Findings and Effective Practices

Findings

- **Inadequate WSPs:**
  - Not having procedures reasonably designed**—based on the types of business the firm engages in—to** identify patterns of manipulative conduct; not identifying specific steps and individuals responsible for monitoring for manipulative conduct; and not outlining escalation processes for detected manipulative conduct.
  - Not tailoring procedures to **reasonably** supervise differing sources of order flow (*e.g.*, proprietary trades, retail customers, institutional customers, foreign financial institutions).
- **Non-Specific Surveillance Thresholds:**
  - Not reasonably designing and establishing surveillance controls to capture manipulative trading (*e.g.*, thresholds not designed to capture the appropriate market class of securities or type of securities or include both customer and proprietary trading or thresholds set too low or too high to identify meaningful activity).
  - Failing to periodically evaluate adequacy of firms' controls and thresholds in light of changes in their business, customer base or the market.
- **Surveillance Deficiencies:**
  - **Not establishing and maintaining a surveillance system reasonably designed to monitor for potentially manipulative trading (*e.g.,* potential layering, spoofing, wash trades, prearranged trades, marking the close, odd-lot manipulation) with parameters that are reasonably designed and documented.**
  - Not adequately monitoring customer activity for patterns of potential manipulation, **including potential prearranged trading across customers**.
  - **Not considering external sources for red flags** (***e.g.,*** **inquiries from regulators or service providers or publicly available information about known manipulators).**
  - **Not performing the timely review of surveillance alerts or exception reports.**
  - **Not dedicating sufficient resources and training to the review of surveillance alerts or exception reports.**
  - Not documenting alert review findings.

Manipulative Trading in Small Cap IPOs

Between 2022 and 2023, FINRA, Nasdaq and NYSE observed that initial public offerings (IPOs) for certain small cap, exchange-listed issuers were targets of potential market manipulation schemes, similar to so-called "ramp and dump" schemes.[12]

FINRA observed significant, unusual price increases on the day of or shortly after the IPOs, which mostly involved issuers with operations in foreign jurisdictions.[13]

In 2024, these schemes evolved:

- FINRA has recently observed these unusual price increases occurring less frequently on the day of or shortly after certain small cap issuers' IPOs, but more frequently in the weeks or months after these IPOs.
- These recent unusual price increases appear to be associated with manipulative trading of shares originating from apparent nominee accounts that invest in small cap IPOs.
- These accounts then sell these shares shortly after the IPO, in a manner which appears to funnel them—through manipulative orders and trading activity—to foreign omnibus accounts that accumulate and later liquidate them for profit.

These market manipulation schemes may also involve defrauding investors:

- FINRA has recently observed an increase in investor complaints regarding social media scams associated with encrypted chat investment clubs, in which bad actors utilize imposter and financial grooming scams to convince investors to purchase shares of small cap companies.[14]
- The victims' purchases occur in conjunction with—and likely cause—price increases in the targeted securities. Notably, these purchases often coincide with liquidations of shares by accounts presumed to be controlled by foreign bad actors.

For additional guidance FINRA recommends these *Investor Insights* articles:

- Investor Alert: Social Media 'Investment Group' Imposter Scams on the Rise (January 11, 2024)
- Investor Alert: This On-Ramp Could Lead You to a Dump (March 30, 2023)

Effective Practices

- **Manipulative Schemes:**
  - Maintaining **a surveillance program that is reasonably designed** to detect manipulative trading schemes (*e.g.*, momentum ignition, layering, front running, trading ahead, spoofing, wash sales, prearranged trading, **marking the close, mini-manipulation**), including **surveillance for cross-product manipulative trading schemes** that involve correlated securities, such as stocks, exchange-traded products (ETPs) and options **(*e.g.*, manipulating the price of a stock to influence the price at which a market participant can either establish or close a related options position).**
  - **Tailoring supervisory systems and processes to differing types of manipulative order entry and trading activity based on product class, including listed and OTC equities, options and fixed income products (*e.g.*, Treasuries).**
  - **Monitoring for red flags associated with customer accounts that may have a relationship with an issuer, such as:**
    - **customer accounts (foreign or domestic) referred by a microcap issuer to the underwriting broker-dealer (particularly when the same officer or CEO has been noted across multiple issuers); and**
    - **money movements between the issuer and customer accounts.**

- **Monitoring for red flags indicating:**
  - **conflicts of interest in private capital raises in advance of IPOs (particularly where a nominee controls shares); and**
  - **the involvement and participation in underwriting and selling activities by unregistered individuals in private and public offerings.**
- **Supervising for efforts by the firm or customers to artificially support or suppress the price, or prevent or reduce natural price falls, of securities.**

- **Multiple Platform and Product Monitoring:** Monitoring activity occurring across multiple platforms, including **platforms that also may involve related financial instruments or multiple** correlated products**, as well as cross-border activity in the same or related products.**
- **Algorithmic Trading:** Using *Regulatory Notice* *15-09* (Guidance on Effective Supervision and Control Practices for Firms Engaging in Algorithmic Trading Strategies) to inform a firm's surveillance program in areas such as general risk assessment and response, software/code development and implementation, software testing and system validation, trading systems, and compliance.
- **ETPs:** Developing and maintaining a robust supervisory system to safeguard material, non-public information to prevent front running and trading ahead by:
  - establishing effective information barriers and controls to prevent information leakage and the misuse of material, non-public information;
  - reviewing for manipulative strategies that exploit the unique characteristics of ETPs (*e.g.*, their creation and redemption processes) and strategies that exploit information leakage related to portfolio composition files; and
  - tailoring the firm's compliance program to align with how the firm trades ETPs.
- **Wash and Prearranged Trading:** Monitoring activity to identify firm customers engaging in wash trading (*e.g.*, to collect liquidity rebates from exchanges) or prearranged trading (*e.g.*, to create the appearance of active trading), by:
  - monitoring accounts identified as related (or in concert) in the firm's wash/prearranged trading surveillance reports; and
  - reviewing trading activity that relates to information provided on account opening documents.

Additional Resources

- Algorithmic Trading Key Topics Page
- Cross-Market Equities Supervision Manipulation Report Card
- *Regulatory Notices*
  - ***Regulatory Notice* *22-25*** **(Heightened Threat of Fraud: FINRA Alerts Firms to Recent Trend in Small Capitalization IPOs)**
  - *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)
  - *Regulatory Notice* *18-25* (FINRA Reminds Alternative Trading Systems of Their Obligations to Supervise Activity on Their Platforms)
  - *Regulatory Notice* *17-22* (FINRA Adopts Rules on Disruptive Quoting and Trading Activity and Expedited Proceedings)

Firm Operations

Third-Party Risk Landscape NEW FOR 2025

Firms rely on third parties for many activities and functions, which can present risks. Over recent years FINRA has observed an increase in cyberattacks and outages at third-party vendors[15] (also known as third-party providers[16]) firms use. Given the financial industry's reliance on third-party vendors to support key systems and covered activities[17], an attempted cyberattack or an outage at a third-party vendor could potentially impact a large number of firms.

Regulatory Obligations

Firms have an obligation to establish and maintain a supervisory system, including establishing and maintaining written supervisory procedures for any activities or functions third-party vendors perform, that is reasonably designed to achieve compliance with applicable securities laws and regulations (*e.g.*, Regulation S-P)[18] and with applicable FINRA rules (*e.g.*, FINRA Rules 3110 and 4370).

Observations and Effective Practices

Observations

Below are areas that have emerged in recent FINRA examinations that firms may consider when developing and enhancing their third-party vendor risk management programs:

- **establishing adequate third-party vendor risk management policies;**
- **conducting initial or ongoing due diligence on third-party vendors that support systems related to key areas (*e.g.*, information technology and cybersecurity; AML monitoring);**
- **validating data protection controls in third-party vendor contracts;**
- **involving third-party vendors that support key systems in the testing of their Incident Response Plan;**
- **maintaining a list of all third-party services, or third-party provided hardware and software components, that the firm's technology infrastructure uses;**
- **having procedures that address the return or destruction of firm data at the termination of a third-party vendor contract; and**
- **addressing third-party vendors' use of vendors (*i.e.,* fourth-party vendors) that may handle firm data.**

FINRA's Firm Outreach

- FINRA's Risk Monitoring program engages with firms on an ongoing basis to understand how firms use and supervise third-party vendors.
- In November 2023, FINRA issued a questionnaire to gather information from firms related to their engagement with third-party vendors, particularly those used for mission critical systems and functions. This information supplemented FINRA's understanding of the potential impact and effect of a third-party vendor event for our firms and the securities markets.
- Additionally, FINRA used the information we gathered to quickly and proactively alert firms of cybersecurity and other vendor-related events that may impact their firm.
- Firms can contact their Risk Monitoring Analyst to report any changes to third-party vendors that support their key systems or any cybersecurity events at these vendors.

Effective Practices

Firms that use—or are contemplating using—third-party vendors may consider these effective practices when assessing and managing the risks associated with third-party vendors during the lifecycle of the relationship, from onboarding to ongoing monitoring, through offboarding, including, for example:

- **maintaining a list of all third-party vendor-provided services, systems and software components that the firm can leverage to assess the impact on the firm in the event of a cybersecurity incident or technology outage at a third-party vendor;**
- **establishing supervisory controls for a third-party technology vendor's business impact, including assessments and contingency plans;**
- **evaluating the impact on the firm's ability to meet its regulatory obligations if the third-party vendor fails to perform the outsourced activity or function;**
- **asking potential third-party vendors if they incorporate Gen AI[19] into their products or services, and, if so, evaluating contracts with these third-party vendors and requesting that they be amended—as necessary—to comply with your firm's regulatory obligations (*e.g.*, adding language that prohibits firm or customer sensitive information from being ingested into a third-party vendor's open-source Gen AI tool);**
- **reviewing, and as appropriate adjusting, third-party vendor tool default features and settings to meet firm business needs and applicable regulatory obligations (*e.g.*, disabling a chat feature, reviewing whether communications are being captured for supervisory review);**
- **assessing third-party vendors' ability to protect sensitive firm and customer non-public information and data; and**
- **ensuring that a third-party vendor's access to systems, data and corporate infrastructure is revoked when the relationship ends.**

Additional Resources

- FINRA
  - **FINRA Cybersecurity Advisory: Increasing Cybersecurity Risks at Third-Party Providers**
  - ***Regulatory Notice* *21-29* (FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors)**
  - ***Notice to Members* *05-48* (Members' Responsibilities When Outsourcing Activities to Third-Party Service Providers)**
  - **The SEC Amends Regulation S-P to Enhance Protection of Customer Information "callout" box in Technology Management topic.**

Artificial Intelligence: Continuing and Emerging Trends

As noted in the 2024 Report, AI-based tools have been widely used in the financial services industry for a number of years. The expansion of AI crosses many business sectors, technologies and operations; this new technology can offer many potential benefits to firms and investors, but may also present certain risks. In light of this, FINRA has increased its discussions and information-sharing with firms on this topic to help identify and mitigate such risks.

FINRA has observed that firms are proceeding cautiously with their use of Gen AI technology, generally exploring or implementing third-party vendor-supported Gen AI tools to increase efficiency of internal functions, including:

- summarizing information from multiple information sources into one document;
- conducting analyses across disparate data sets (*e.g.*, assessing and validating the accuracy of reported transactions with source documentation); and
- utilizing Gen AI for employees to retrieve relevant portions of policies or procedures.

FINRA is also engaging with firms to stay current on the evolving AI landscape and potential impacts for the industry:

- FINRA issued a questionnaire to firms in November 2023 concerning their use of third-party vendors that included questions on third-party vendor-supported AI.[20] FINRA has followed up with firms based on their responses to the survey and further outreach is ongoing.
- In June 2024, FINRA issued *Regulatory Notice 24-09* (FINRA Reminds Members of Regulatory Obligations When Using Generative Artificial Intelligence and Large Language Models), reminding firms of their regulatory obligations when using Gen AI and large language models (LLMs) and inviting continued engagement through FINRA's process for interpretive requests, or discussions with your firm's Risk Monitoring Analyst.[21]

FINRA intends for its rules to be technologically neutral, and they continue to apply when firms use Gen AI or similar technologies in the course of their businesses, just as they apply when firms use any other technology or tool. As with any technology or tool, a firm should evaluate Gen AI tools prior to deploying them and ensure the firm can continue to comply with existing FINRA rules applicable to the business use of those tools.

Firms contemplating the use of Gen AI tools and technologies may want to consider:

- how to supervise the use of Gen AI on an enterprise level (as well as by individual associated persons);
- how to identify and mitigate associated risks, for example, regarding accuracy or bias; and
- whether the firm's cybersecurity program considers:
  - risks associated with the firm's and third-party vendor's use of Gen AI (*e.g.*, leakage of customer PII and the firm's proprietary information entered into prompts by employees); and
  - use of technology tools, data provenance, and processes to identify the use of AI or Gen AI by threat actors.

Firms contemplating using a third-party vendor-driven Gen AI tool may want to consider how to use that tool and still ensure compliance with applicable regulatory requirements and undertakings, including with respect to:

- the deployment of foundation models provided by third-party vendors (*e.g.*, OpenAI, Anthropic, Google, Meta, open-source); and
- third-party software vendors that are including Gen AI within their existing solutions.

Finally, all firms may want to consider whether the firm's cybersecurity program addresses risks associated with threat actors' potential exploitation of Gen AI to increase the number, credibility or severity of attacks (*e.g.*, fake web personas, deepfake audio and video, creation of advanced malware and other malicious tools).

For additional guidance related to AI please see:

- the Emerging Risk: Adversarial Use of Generative Artificial Intelligence "callout" box in the Anti-Money Laundering, Fraud and Sanctions topic
- the Communications with the Public topic in the 2025 Report (for guidance concerning communications that are created by, or promote a firm's use of, AI)
- FINRA FinTech Key Topics Page
- *Regulatory Notice 24-09* (FINRA Reminds Members of Regulatory Obligations When Using Generative Artificial Intelligence and Large Language Models)
- Frequently Asked Questions About Advertising Regulation, Questions B.4 and D.8 (May 10, 2024)
- FINRA Podcast: An Evolving Landscape: Generative AI and Large Language Models in the Financial Industry (March 5, 2024)
- FINRA, SEC, NASAA Investor Insight: Artificial Intelligence (AI) and Investment Fraud (January 25, 2024)
- *Regulatory Notice 21-29* (FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors)
- FINRA Report – Artificial Intelligence (AI) in the Securities Industry (June 10, 2020)
- National Institute of Standards and Technology (NIST): Artificial Intelligence Risk Management Framework (AI RMF 1.0) (January 2023)

Technology Management

Regulatory Obligations

Rule 30 of SEC Regulation S-P requires firms to have written policies and procedures that address administrative, technical and physical safeguards for the protection of customer records and information. **Newly adopted amendments to Regulation S-P also address incident response programs and require customer notification in the case of unauthorized access or use of customer information**. Regulation S-ID (Identity Theft Red Flags) requires firms to develop and implement a written program reasonably designed to detect, prevent and mitigate identity theft in connection with the opening or maintenance of "covered accounts."[22]

FINRA Rule 4370 (Business Continuity Plans and Emergency Contact Information) also applies to denials of service and other interruptions to firms' operations. FINRA reminds firms that cybersecurity remains one of the principal operational risks facing financial entities.

SEC Amends Regulation S-P to Enhance Protection of Customer Information

On May 16, 2024, the SEC adopted amendments to Regulation S-P intended to modernize and enhance the rules that govern the treatment of consumers' nonpublic personal information.

The amendments broaden the scope of information covered by Regulation S-P's requirements, requiring covered institutions to, among other things:

- develop, implement and maintain written policies and procedures for an incident response program that is reasonably designed to detect, respond to and recover from any unauthorized access or use of customer information;
- notify affected individuals whose sensitive customer information was, or is reasonably likely to have been, accessed or used without authorization as soon as practicable (but no later than 30 days after becoming aware that unauthorized access to or use of customer information has occurred or is reasonably likely to have occurred); and
- have an incident response program that includes the establishment, maintenance and enforcement of written policies and procedures that are reasonably designed to require oversight, including through due diligence and monitoring, of service providers.

Larger entities must comply with the amendments by December 2, 2025, while smaller entities must comply with the amendments by June 3, 2026. FINRA recommends that all firms review the amendments to ensure they modify their cybersecurity programs, as needed, by the compliance date applicable to their firms.

For additional information, please see the SEC's Adopting Release and Fact Sheet concerning the Regulation S-P amendments.

Findings, Observations and Effective Practices

Findings

- **WSPs:** Not updating WSPs to reflect the firm's current cybersecurity practices; and not enforcing the firm's WSPs related to cybersecurity.
- **Supervision: Not establishing and maintaining a supervisory system reasonably designed to safeguard customer records and information per Regulation S-P.**
- **Identity Theft Prevention Program (ITPP): Not establishing an ITPP reasonably designed to detect, prevent and mitigate identify theft per Regulation S-ID (*e.g.*, not reviewing large volume of red flags indicating accounts were opened with stolen or false identities); and not responding appropriately to red flags the ITPP detected.**
- **Inaccurate Privacy Notices: Providing customers with privacy notices that inaccurately state the extent to which the firm uses their nonpublic personal information.**

Observations

- **Branch Office Security Controls:** Not establishing security controls that branch offices must follow when they maintain their own email systems or other application systems or servers; and not detecting and responding when a branch office is not compliant with established security controls for maintaining a branch-hosted email or application server.
- **Third-Party Vendor Supply Chain Management:** Not maintaining a list of all third-party services, or **third-party-provided** hardware and software components, that the firm's technology infrastructure uses.
- **Data Loss Prevention (DLP):** Not monitoring network activity to identify unauthorized copying or deletion of customer or firm data, and not monitoring outbound emails to identify sensitive customer data in text or attachments.

- **Log Management Practices:** Not sufficiently logging or retaining data related to business or technical activities to effectively assist with the forensic analysis of cybersecurity incidents (*e.g.*, determining the entry point and scope of an attack).
- **ITPP:** Implementing a generic ITPP that is not appropriate for the firm's size, complexity, and the nature and scope of the firm's activities, and not periodically updating the firm's ITPP to reflect changes in identify theft risks.
- **SAR Filings:** Not having reasonably designed procedures for investigating cybersecurity events and considering whether a SAR filing is required, consistent with applicable guidance from FinCEN.

Effective Practices

- **Account Access Authentication:** Requiring multi-factor authentication (MFA) for login access to the firm's operational, email and registered representatives' systems for employees, contractors and customers, and using tools to identify potential unauthorized access to the firm's internal and customer-facing systems.
- **Data Backups:** Completing regular backups of critical data and systems, and ensuring the backup copies are encrypted and stored off-network; and regularly testing the recovery of data from backups to ensure information can be restored from backup systems.
- **Third-Party Vendor Management:** Maintaining a list of all third-party-provided services, systems and software components that can be leveraged to assess firm impact in the event of a cybersecurity incident at one of the firm's third-party vendors.
- **Branch Office Procedures:** Limiting the use of branch-managed servers for email or other applications (*e.g.*, customer relationship management, reporting) and, if branch-managed servers are permitted, ensuring adequate security controls are maintained.
- **Risk Assessments:** Regularly assessing the firm's cybersecurity risk profile based on changes in the firm's size and business model and newly identified threats; and regularly updating the firm's cybersecurity program and AML program based on those assessments.
- **Secure Configurations:** Confirming that desktops, laptops and servers are using current software systems with secure settings that expose only required services to reduce system vulnerabilities; and implementing timely application of systems security patches, **especially those addressing known vulnerabilities that are actively being exploited by threat actors.**
- **Digital Transformation and the Adoption of Cloud:** Planning and design process used when adopting cloud-based systems or technology to ensure adequate preparation.
- **Log Management:** Capturing log data from a broad set of sources and retaining it for a sufficient amount of time (*e.g.*, a minimum of 24 months).
- **IT Resiliency:** Implementing and testing firm controls to ensure established acceptable service levels are maintained during disruption of critical business operations relying on IT systems.

Additional Resources

- FINRA
  - **The Third-Party Risk Landscape topic**
  - **2024 Cybersecurity Conference**
  - Cybersecurity Key Topics Page, including:
    - Small Firm Cybersecurity Checklist (September 7, 2023)
    - Core Cybersecurity Threats and Effective Controls for Small Firms (May 5, 2022)

- SEC
  - **SEC Adopts Rule Amendments to Regulation S-P to Enhance Protection of Customer Information (May 16, 2024)**
  - **Enhancements to Regulation S-P: A Small Entity Compliance Guide**
  - SEC Proposes to Expand and Update Regulation SCI (March 22, 2023)
  - SEC Proposes New Requirements to Address Cybersecurity Risks to the U.S. Securities Markets (June 7, 2023)

Outside Business Activities and Private Securities Transactions

Regulatory Obligations

FINRA Rules 3270 (Outside Business Activities of Registered Persons) and 3280 (Private Securities Transactions of an Associated Person) require registered persons 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 prohibit, 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.

Findings and Effective Practices

Findings

- **Incorrect Interpretation of Selling Compensation for Potential PSTs:** Interpreting “selling compensation” too narrowly (by focusing on only direct compensation, such as commissions, rather than evaluating all direct and indirect financial benefits from PSTs, such as receipt of securities and tax benefits); and, as a result, erroneously determining that certain activities were not PSTs for compensation.
- **Inadequate Approval Process for Potential PSTs:** Approving participation in proposed PSTs for compensation without adequately considering how the individual’s participation in the proposed PSTs would be supervised as if the transactions were executed on the firms’ behalf.
- **No Documentation:**
  - Not supervising a person’s participation in PSTs or recording such transactions on the firm’s books and records.
  - Not retaining the documentation necessary to demonstrate the firm’s compliance with the supervisory obligations for PSTs involving compensation.
  - Not recording transactions for compensation on the firm’s books and records because certain PSTs were not consistent with the firm’s electronic systems (such as where securities transactions conducted by an associated person 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 provide prior written notice to their firms of OBAs or, for associated persons, of 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 the firm’s limitations placed on OBAs or PSTs, such as prohibiting registered persons from soliciting firm clients to participate in an OBA or PST.
- **No Review and Recordkeeping of Crypto Asset-Related Activities:** Assuming that all crypto assets are not securities and therefore not evaluating crypto asset-related activities, including activities performed through affiliates, to determine whether they should be treated as PSTs; and failing to approve or follow required rule steps with respect to crypto asset-related OBAs and PSTs.

Effective Practices

- **Questionnaires:** Requiring registered persons 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, which include questions concerning:
  - 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, payments, or direct and indirect financial benefits they receive from any entities other than the firm, including affiliates.
- **Due Diligence:** Conducting due diligence to learn about all OBAs and PSTs at the time of a registered person’s initial disclosure to the firm and periodically thereafter, including interviewing the registered person 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 investment advisers or fund companies in order to identify potential PSTs.
- **Monitoring:** Monitoring significant changes in, or other red flags relating to, registered persons’ 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;
  - financial records (including bank statements and tax returns);
  - branch office activities; and
  - gifts and gratuities logs.
- **Affiliate Activities:** Considering whether registered persons’ 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, as well as defining selling compensation and in some cases providing FAQs to remind employees of scenarios that they might not otherwise consider, which could 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 public 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.

- **Controls for Outside Crypto Asset-Related Activities**
  - Establishing policies, procedures and controls related to crypto asset-related OBAs of registered persons that clearly detail:
    - the conditions under which crypto asset OBAs will be prohibited (and when limitations on the activity will be imposed); and
    - how the firm will assess whether the activity is a PST, such as when crypto assets are sold as investment contract securities.
  - Searching for indicators of undisclosed crypto asset-related OBAs and PSTs during reviews of electronic correspondence.

Additional Resources

- *Notice to Members 96-33* (NASD Clarifies Rules Governing RR/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

SEA Rules 17a-3 and 17a-4 specify minimum requirements with respect to the records that broker-dealers must make, how long those records and other documents relating to a broker-dealer's business must be kept, and in what format they may be kept. SEA Rule 17a-4(b)(4) and FINRA Rules 3110(b)(1) (Supervision), 3110.09 (Retention of Correspondence and Internal Communications), and 2210(b)(4) (Communication with the Public) require firms to establish, maintain and enforce written procedures to supervise the types of business in which they engage and the activities of their associated persons that are reasonably designed to, among other things, create and preserve, in an easily accessible place, originals of all communications received and sent relating to their "business as such" (*e.g.*, emails, instant messages, text messages, chat messages, interactive blogs). In addition, FINRA Rule 3110(b)(1) (Written Procedures) requires firms to establish, maintain and enforce written procedures to supervise the types of business in which they engage and the activities of their associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

FINRA Rule 4511(a) (General Requirements) requires firms to make and preserve books and records as required under the FINRA Rules, the SEA and applicable SEA Rules. The obligations set forth in SEA Rules 17a-3 and 17a-4 and FINRA Rules 2210(b)(4) and 4511(a) (collectively, Books and Records Rules) apply to all firms.

SEA Rule 17a-4 sets forth the requirements regarding the maintenance and preservation of electronic records, including the use of third-party recordkeeping services to hold records and the prompt production of records. Effective January 3, 2023, the SEC amended these requirements. In part, these amendments impact the required language of the third-party access undertakings applicable to firms that use an electronic recordkeeping system to maintain and preserve records required under SEA Rules 17a-3 and 17a-4. As a result, those firms that preserve required records electronically, including those firms that elect to continue using their current third-party access arrangements, must file with FINRA updated third-party access undertakings that reflect the new language specified under SEA Rule 17a-4(f)(3)(v).

Recent Amendments Concerning FINRA Rule 2231 (Customer Account Statements)

- Effective January 1, 2024, FINRA Rule 2231 (Customer Account Statements) now includes eight supplementary material sections, one of which pertains to the disclosure of a customer's assets that are not held at the firm.
- FINRA Rule 2231.06 (Assets Externally Held) provides that for a customer's externally held assets, the customer's account statement must:
  - clearly identify and distinguish those assets on customer account statements;
  - clearly indicate that such externally held assets are included on the statement solely as a courtesy to the customer;
  - disclose that information, including valuation, for such externally held assets is derived from the customer or other external source for which the firm is not responsible; and
  - identify that such externally held assets may not be covered by Securities Investor Protection Corporation (SIPC).
- For additional guidance—including summaries of all eight Supplementary Materials sections and the amended text for the rule—please see *Regulatory Notice 23-02* (FINRA Amends FINRA Rule 2231).

Findings and Effective Practices

Findings

- **Not Maintaining Email Correspondence:** Not capturing, reviewing and archiving electronic correspondence of associated persons—including part-time chief compliance officers and Financial and Operations Principals (FINOPs)—conducting firm business via third-party vendor email addresses.
- **Not Maintaining Electronic Communications: Not retaining, archiving and reviewing non-email electronic communications conducted through firm-approved channels.**
- **Not Maintaining Converted Records:** Not maintaining policies and procedures and related controls to protect the integrity of records from the time the records are created or received throughout the applicable retention period, and confirm physical books and records converted to electronic records were accurate, complete and readable.
- **Inadequate Due Diligence of Third-Party Vendors:** Not performing adequate due diligence to verify third-party vendors' ability to comply with Books and Records Rules requirements; or not confirming that service contracts and agreements comply with applicable Books and Records, including records stored by third-party vendors.
- **Inadequate Supervision:**
  - **Not reviewing electronic communications for indications of associated persons' potential use of off-channel communications.**[23]
  - Not establishing procedures and controls to retain and review written, business-related electronic communications made through non-firm-approved email accounts and other communication **tools**.
  - **Not preserving and reviewing business-related text messages.**
- **Inadequate WSPs: Relying on policies and procedures that were overly general and did not adequately specify:**
  - **permitted and prohibited platforms;**
  - **methods to determine if registered representatives are engaging in business communications on unapproved platforms; and**
  - **corrective actions for registered representatives if they violate firm policy and engage in business communication using unapproved platforms.**

- **Contacting Firm Customers Through Off-Channel Platforms: Associated persons using personal email accounts, and other off-channel platforms to communicate with customers when conducting firm business.**
- **Inadequate Reviews: Reviewing electronic communications without selecting adequate samples or using targeted key word searches; and failure to review electronic communications in non-English languages in which the member conducts business.**
- **Inadequate Third-Party Vendor Supervision: Not properly supervising third-party vendors that support firms' monitoring of their associated persons' electronic communications, resulting in firms not supervising or retaining communications.**

Effective Practices

- **Testing and Verification:** Testing recordkeeping third-party vendors' capabilities to fulfill regulatory obligations by, for example, simulating a regulator's examinations by requesting records to confirm compliance with the recordkeeping requirements.
- **Providing Appropriate Access to Books and Records: If your firm uses a part-time Financial and Operations Principal (FINOP), contracted chief compliance officer (CCO), or a part-time employee or contractor for other roles, ensuring there is a process in place to set up appropriate access to the firm's books and records to allow for the individuals to fulfill their regulatory obligations.**
- **Supervisory Procedures:**
  - **Monitoring for indications that associated persons are using off-channel communications (*e.g.*, a decrease or cease in activity on certain previously used firm-approved communication channels or tools).**
  - **Frequently revising key words used to surveil for associated persons' potential use of off-channel communications, and tailoring key word searches to the business models.**

Additional Resources

- FINRA
  - Books and Records Key Topics Page
  - Books and Records Requirements Checklist
  - Exchange Act Rule 17a-4 Amendments: Chart of Significant Changes
  - *Regulatory Notice* *18-31* (SEC Staff Issues Guidance on Third-Party Recordkeeping Services)
  - Frequently Asked Questions about the 2001 Amendments to Broker-Dealer Books and Records Rules Under the Securities Exchange Act of 1934
- SEC
  - Fact Sheet: Final Amendments to Electronic Recordkeeping Requirements (October 12, 2022)

Senior Investors and Trusted Contact Persons

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.

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.

FINRA Rule 2165 (Financial Exploitation of Specified Adults) permits firms to place temporary holds on a disbursement of funds or securities and securities transactions when firms reasonably believe that financial exploitation has occurred, is occurring, has been attempted or will be attempted, and requires firms to notify the TCP, if available, when placing temporary holds.

Findings and Effective Practices

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 the 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 customer opens a new non-institutional account or when the firm updates an existing account's information (in accordance with FINRA Rule 4512(b)).
- **No Documented Training:** Relying on FINRA Rule 2165 but not developing and documenting training policies or programs reasonably designed to ensure associated persons comply with the requirements of the rule.
- **No Documented Internal Review:** Relying on FINRA Rule 2165 but not retaining records that document the firm's internal review underlying the decision to place a temporary hold on a disbursement or transaction.
- **Attempted Circumvention of FINRA Rule 3241:** Registered persons attempting to circumvent the rule's requirements by having customers name the registered person's spouse or other family members as beneficiaries for customers' accounts.

Protecting Vulnerable Adult and Senior Investors

- FINRA has issued a Threat Intelligence Product (TIP) regarding the vulnerability of senior investors to investment scams.
- This TIP provides observations regarding:
  - common tactics used by scammers to defraud senior investors and vulnerable adults;
  - the devastating consequences for the victims; and
  - the importance of education about financial scams to prevent initial victimization and re-victimization.
- For additional guidance regarding senior investor protection, please see:
  - the Investment Fraud by Bad Actors Targeting Investors Directly "callout" box in the Anti-Money Laundering, Fraud and Sanctions topic; and
  - the Additional Resources section below.

Effective Practices

- **Customer Outreach: Engaging in communication campaigns on fraud awareness, hosting educational webinars and providing customers with other resources to educate them on the latest scams.**
- **Firm Outreach:** Hosting conferences or joining industry groups focused on protecting senior customers.
- **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.
  - Providing guidance to registered representatives regarding contacting TCPs when the firm places a temporary hold.
- **Customer Account Tracking: Implementing a process to track whether customer accounts have designated TCPs, and then focusing outreach efforts on accounts that do not have TCPs.**
- **Supervisory Procedures:** When establishing procedures for FINRA Rule 2165 related to placing temporary holds, **contemplate how the firm will ensure supervisory procedures and WSPs related to the identification, escalation and reporting of matters involving the financial exploitation of Specified Adults will be handled.**
- **Escalation Process:** Implementing and training registered representatives to use a comprehensive process to escalate issues relating to seniors, including but not limited to concerns about financial exploitation, diminished capacity or cognitive decline.
- **Senior Investor Specialists:** Establishing specialized groups or appointing individuals to handle situations involving elder abuse or diminished capacity; contacting customers' TCPs—as well as Adult Protective Services, regulators and law enforcement, when necessary—and guiding the development of practices focused on senior customers.
- **Training:** Conducting training, for both front office and back office staff, on **common financial and investment scams and** the warning signs of potential (1) fraud or exploitation perpetrated on the customer or (2) diminished capacity.

Additional Resources

- FINRA
  - Senior Investors Key Topics Page
  - **Threat Intelligence Product: Protecting Vulnerable Adult and Senior Investors**
  - **2024 FINRA Annual Conference: Advances in Senior Investor Protection**
  - *Regulatory Notices*
    - *Regulatory Notice 22-31* (FINRA Shares Practices for Obtaining Customers' Trusted Contacts)
    - *Regulatory Notice 22-05* (FINRA Adopts Amendments to FINRA Rule 2165)
    - *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)
    - *Regulatory Notice 20-30* (Fraudsters Using Registered Representatives Names to Establish Imposter Websites)
    - *Regulatory Notice 19-18* (FINRA Provides Guidance to Firms Regarding Suspicious Activity Monitoring and Reporting Obligations)
  - FINRA Unscripted Podcasts
    - **Fighting Financial Exploitation: FINRA's Vulnerable Adults and Seniors Team (April 30, 2024)**
    - The Essential Senior Investor Protection Tools: FINRA Rules 2165 and 4512 (May 3, 2022)
- FINRA, NASAA and SEC
  - NASAA/SEC/FINRA Training: Addressing and Reporting Financial Exploitation of Senior and Vulnerable Adult Investors (June 2023)
- FBI
  - **FBI Elder Fraud Report 2023**
- FinCEN
  - FinCEN Advisory: Advisory on Elder Financial Exploitation (June 15, 2022)

Crowdfunding Offerings: Broker-Dealers and Funding Portals

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 allows eligible issuers to offer and sell securities exclusively through the platform of an intermediary (*i.e.*, a firm that is registered with the SEC—either as a broker-dealer or as a funding portal—and is also a FINRA member).

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-dealer firms contemplating engaging in the sale of securities in reliance on Title III of the JOBS Act must notify FINRA in accordance with FINRA Rule 4518 (Notification to FINRA in Connection with the JOBS Act).

In addition to providing the required notification to FINRA, depending on the facts and circumstances, broker-dealer firms may also need to apply for approval of a material change in business operations by filing a Form CMA, and paying related fees, unless they are already approved by FINRA to engage in private placements or underwriting.[24]

Regulation Crowdfunding imposes certain gatekeeper responsibilities on intermediaries. Rule 301(a) under Regulation Crowdfunding provides in part that an intermediary must have a reasonable basis for believing that an issuer seeking to offer and sell securities through the intermediary's platform complies with the requirements of Regulation Crowdfunding. Furthermore, Rule 301(c)(2) requires an intermediary to deny access to its platform if it has a reasonable basis for believing the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection. **Moreover, with respect to an intermediary that is a funding portal, Rule 300(c)(2)(iv) prohibits it from holding, managing, possessing or otherwise handling investor funds or securities. Rule 303(e)(2) requires the funding portal to direct investors to transmit the money or other consideration directly to a "qualified third party" that has agreed in writing to hold the funds for the benefit of, and to promptly transmit or return the funds to, the persons entitled thereto.**

Additionally, Rule 404 under Regulation Crowdfunding imposes certain recordkeeping requirements on funding portals. (Broker-dealer firms that engage in Regulation Crowdfunding transactions are subject to the full recordkeeping requirements under SEA Rules 17a-3 and 17a-4, as well as FINRA Rule 3110(b) (Supervision) and the 4510 (Books and Records) Rule Series.) Rule 404 requires funding portal members to make and preserve certain records relating to their funding portal activities. Using a third party to prepare and maintain records on behalf of a funding portal does not relieve the funding portal of its recordkeeping responsibilities.

Findings and Effective Practices

Findings

- **Inadequate Supervision:**
  - **Not establishing and maintaining a supervisory system that is reasonably designed to ensure the content of email communications with investors complies with the requirements of Regulation Crowdfunding.**
  - **Not establishing a system to track investments.**
  - **Not supervising access to the funding portal's bank accounts.**
- **Failure to Obtain Written Undertaking:** Not obtaining the written undertaking 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 these individuals held 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, and the material terms of any indebtedness of the issuer; and
  - financial statements, as required by Regulation Crowdfunding Rule 201(t).
- **Failing to Report Written Customer Complaints: Not reporting written customer complaints regarding investor funds through FINRA Gateway.**
- **Late Filings:** Not making required filings in a timely manner—such as filing the funding portal's Statement of Gross Revenue by the March 1 deadline—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).
- **Offering Investment Advice or Recommendations; Soliciting Purchases, Sales or Offers:** Sending electronic correspondence to customers that recommend investments or otherwise solicit purchases of securities, thereby violating the prohibitions under Regulation Crowdfunding Rule 402(a) against funding portals engaging in such activity.

- **Misleading Statements:** Failing to correct misleading statements that appeared on funding portals' websites for offerings on their platforms.
- **Failing to Transmit Funds:** Failing to promptly direct the transmission of funds to the issuers upon the successful completion of the offerings, or to return funds to investors upon cancellation of the offerings or in the event of oversubscription.
- **Failing to Take Measures to Reduce Risk of Fraud:** Not denying issuers or offerings access to funding portals' platforms, after funding portals had become aware of warning signs of potentially fraudulent activity during the onboarding process and during issuers' campaigns.
- **Issues Regarding Maintenance and Transmission of Funds:**
  - **Directing investors to transmit funds, in connection with a Regulation Crowdfunding offering, through an entity that is not the qualified third party.**
  - **Failing to promptly direct the transmission of funds to the issuers upon the successful completion of the offerings, or to return funds to investors upon cancellation of the offerings, left in dormant escrow accounts or in the event of oversubscription.**
  - **Directing an escrow agent to release investor funds to an account controlled by the firm's parent, rather than the issuer or investor.**

Effective Practices

- **Compliance Resources:**
  - Developing annual compliance questionnaires to verify the accuracy of the funding portal's reporting regarding its associated persons **for purposes of Funding Portal Rule 300(c).**
  - **Developing potential** follow-up questions (such as whether **the associated persons of the funding portal** have ever filed for bankruptcy, have any pending lawsuits, are subject to unsatisfied judgments or liens or received any written customer complaints).
  - **Using** compliance checklists and schedules to confirm that **issuer disclosures required under Regulation Crowdfunding Rule 201 are being made available to investors on the funding portal's platform in compliance with Regulation Crowdfunding Rule 303(a).**
- **Supervision:** Implementing supervisory review procedures for 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.
- **Transmission of Funds: Reviewing existing funds instructions to ensure investors are only being directed to send funds for their investment(s) to a qualified third party (and no other entity) acting as escrow agent for the offering.**
- **Checklist: Utilizing the Written Supervisory Procedures Checklist for Funding Portals to ensure the firm's written supervisory procedures address applicable areas of Regulation Crowdfunding and the FINRA Funding Portal Rules.**

Additional Resources

- FINRA
  - Funding Portals Page
- SEC
  - **Frequently Asked Questions Regarding Regulation Crowdfunding and Intermediary Requirements (September 25, 2018)**

Member Firms' Nexus to Crypto

Background

Crypto assets—also known as digital assets—are assets issued or transferred using distributed ledger or blockchain technology. **While many kinds of market participants engage in crypto asset activities, FINRA has jurisdiction only over its member firms and their associated persons. Federal securities laws and FINRA rules generally apply to member firm activities involving crypto assets that are securities, including those that are offered and sold as an investment contract (which is a type of security). In addition, certain FINRA rules apply to the activities of firms and their associated persons irrespective of whether the activity involves a security.**

Findings and Effective Practices

Findings

While not exhaustive, themes identified with respect to violations by member firms and associated persons involving crypto assets or crypto asset ETPs include:

- **2210 (Communications with the Public)**:
  - Not appropriately and accurately addressing relevant risks and including appropriate disclosures in communications with the public.
  - Disseminating promotional materials that contain false and misleading statements or omissions in connection with securities offerings involving crypto assets, including:[25]
    - Failing to clearly differentiate in communications, including those on mobile apps, between crypto assets offered through an affiliate of the firm or another third party, and products and services offered directly by the firm itself.
    - Making false statements or **falsely implying** that crypto assets functioned like cash or cash-equivalent instruments, or making other false or misleading statements or claims regarding crypto assets.
    - Comparing crypto assets to other assets (*e.g.,* stock investments or cash) without providing a sound basis to compare the varying features and risks of these investments.
    - Providing misleading explanations of how crypto assets work and their core features and risks.
    - Failing to provide a sound basis to evaluate crypto assets by omitting explanations of how crypto assets are issued, held, transferred or sold.
    - Misrepresenting **that the protections of** the federal securities laws or FINRA rules applied to the crypto assets.
    - Making misleading statements about the extent to which certain crypto assets are protected by SIPC under the Securities Investor Protection Act (SIPA).
- **3110 (Supervision):** Not conducting appropriate due diligence on crypto asset private placements offered to customers.
- **3310 (Anti-Money Laundering Compliance Program):** Not establishing and implementing AML programs reasonably designed to detect and cause the reporting of suspicious crypto asset transactions occurring by, at or through the broker-dealer, including suspicious trading involving issuers with a purported involvement in crypto asset-related activities.

Effective Practices

- **Due Diligence of Unregistered Offerings:** Before crypto assets **that are securities or that are offered and sold as securities** are made available to customers through an unregistered offering, understanding:
  - **the exemption from registration on which the unregistered offering will rely;**
  - where the assets will be maintained;
  - who will have access to the wallet(s);
  - how the funds or assets will be returned in the event of a contingent offering not meeting the minimum contingency;
  - how the raised proceeds will be used;
  - **token governance and ownership rights or allocations related to owning a token; and**
  - the specific mechanics associated with the crypto asset **that is a** security **or that is offered or sold as a security,** including:
    - the blockchain protocol used to issue the security **(including related cybersecurity risks)**;
    - any smart contract features or functionalities;
    - how and when the security will be delivered to customers; and
    - how the security will be custodied by or for the customers.[26]
- **On-Chain Reviews:** Conducting risk-based on-chain assessments when the firm or its associated persons are accepting, trading or transferring crypto assets, and establishing procedures that address when and how these on-chain reviews should be performed and documented based on the product or services being offered.
- **Customer Outreach:** Ensuring customers clearly understand:
  - the differences between their brokerage account and any linked/affiliated crypto account, including differences in:
    - protections of the accounts via SIPC under SIPA;
    - regulatory oversight; and
    - firm supervision; and
  - avenues of communications for customers' concerns, questions or complaints.
- **Reviewing Retail Communications:** Ensuring that retail communications concerning crypto assets provide a fair and balanced presentation of the risks associated with these assets, including:
  - the speculative nature of crypto assets (*e.g.*, their significant volatility, the potential for investors to lose the entire amount they invest);
  - that certain legal or regulatory protections that are normally available for traditional securities are not available for most crypto assets (*e.g.,* SIPC protections apply only to cash and securities held for an investor for certain purposes in a customer securities account at a SIPC-member broker-dealer and do not apply to crypto assets that do not qualify as SIPA "securities");
  - the extent to which the protections provided by transacting through a SEC-registered entity will or will not apply[27];
  - regulatory uncertainty concerning the crypto assets; and
  - fraud risks that may be present.

- **Differentiating Crypto Asset Products Communications From Broker-Dealer Products Communications:** Identifying, segregating and differentiating firms' communications related to broker-dealer products and services from those related to offerings by affiliates or third parties, including crypto asset affiliates; and clearly and prominently identifying in communications non-broker-dealer affiliates or other third parties responsible for non-securities crypto 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).

Crypto Asset-Related Market Abuse (Updated for 2025)

Bad actors are taking advantage of investor interest in crypto assets and blockchain technology by engaging in manipulative schemes similar to those that exist in the equities market, including those that are commonly associated with low-priced securities (*e.g.*, pump-and-dump schemes).

- These manipulative schemes may also be amplified by social media promotions, including those that suddenly and frequently appear across social media platforms, contain unverifiable information, or both.
- Additional forms of market abuse involving crypto assets may result from differences in their market structure (*e.g.*, centralized and decentralized exchanges, the ability to trade every day and at any time).

For additional guidance related to addressing market abuse in crypto assets please see:

- the Manipulative Trading topic in the 2025 Report
- ***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)**
- *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* *15-09*** **(Guidance on Effective Supervision and Control Practices for Firms Engaging in Algorithmic Trading Strategies)**
- ***Regulatory Notice* *09-31*** **(FINRA Reminds Firms of Sales Practice Obligations Relating to Leveraged and Inverse Exchange-Traded Funds)**

Additional Resources

- FINRA
  - **The Communications with the Public topic**
  - **Crypto Assets Key Topics Page, including:**
    - **FINRA Provides Update on Member Firms' Crypto Asset Activities (August 13, 2024)**
    - **FINRA Provides Update on Targeted Exam: Crypto Asset Communications (January 23, 2024)**
    - **Guidance for Digital Asset Applications (June 28, 2023)**
- FINRA Unscripted Podcasts:
  - **An Update on FINRA's Crypto Asset Work and the Crypto Hub (July 23, 2024)**
  - **Compliance and Communication: An Update on FINRA's Crypto Asset Targeted Exam (January 23, 2024)**
- SEC
  - Custody of Digital Asset Securities by Special Purpose Broker-Dealers (Dec. 23, 2020)
  - ATS Role in the Settlement of Digital Asset Security Trades (Sept. 25, 2020)
  - Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities (July 8, 2019)

FINRA Rules Concerning Remote Inspections Pilot Program and Residential Supervisory Location Designation

Over the years, advances in technology and communications in the financial industry have significantly changed the way in which firms and their associated persons conduct business. In recognition of these changes, FINRA adopted FINRA Rules 3110.18 (Remote Inspections Pilot Program) and 3110.19 (Residential Supervisory Location), which reflect a measured, modernized approach to supervision while preserving investor protection objectives.

Remote Inspections Pilot Program

- Effective July 1, 2024, Rule 3110.18 sets forth the terms of a voluntary, three-year Remote Inspections Pilot Program (Pilot Program) to allow eligible firms the option of fulfilling their Rule 3110(c)(1) (Supervision) obligations by conducting remote inspections of some or all branch offices, including offices of supervisory jurisdiction (OSJs) and non-branch locations (*i.e.*, unregistered offices or non-registered locations).
- The Pilot Program provides FINRA the opportunity to gauge, through the information Pilot Program participants will provide to FINRA, the effectiveness of remote inspections as an additional approach for firms to meet their supervision obligations that may help shape potential rule amendments or update guidance about inspections generally.
- Pilot Year 1, covering July 1, 2024, through December 31, 2024, has concluded. Pilot Year 2 is underway, running from January 1 to December 31, 2025, and firms had until December 27, 2024, to affirmatively opt in for Pilot Year 2.
- Opt-in timelines for other Pilot Years are as follows:
  - Pilot Year 3 is scheduled for January 1 to December 31, 2026, and firms may affirmatively opt in for Pilot Year 3 on or before December 27, 2025.
  - Pilot Year 4 is scheduled for January 1 to June 30, 2027, and firms may affirmatively opt in for Pilot Year 4 on or before December 27, 2026.
- Firms that opt in for a Pilot Year agree to participate in the Pilot Program for the duration of the Pilot Year under the terms of the rule and will be automatically deemed to have elected to participate in the Pilot Program for subsequent Pilot Years.
- For additional information concerning the Pilot Program, please see FINRA's Remote Inspection Pilot Program Key Topics page.

Residential Supervisory Location Rule

- Effective June 1, 2024, Rule 3110.19 establishes a new non-branch location called the "residential supervisory location" (RSL)—generally defined as a private residence at which an associated person engages in supervisory activities (including those described under FINRA Rule 3110(f)).
- To use the RSL designation, a firm and the associated person at each location must meet specified eligibility requirements and conditions as detailed in the rule.
- As firms determine which offices or locations may be eligible for the RSL designation, FINRA reminds them of their obligations to:
  - identify their RSLs through Form U4 (Uniform Application for Securities Industry Registration or Transfer) by answering the "RSL Question" (see File No. SR-FINRA-2024-015); and
  - submit Form BR (Uniform Branch Office Registration Form) to register or close their branch offices (as applicable).
- For additional information concerning RSLs, including RSL identification through Form U4 and Form BR submissions to account for the RSL designation, please see FINRA's Residential Supervisory Locations (RSLs) Key Topics page.

Communications and Sales

Communications With the Public

Regulatory Obligations

FINRA Rule 2210 (Communications with the Public) defines **three categories of firm written** communications—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 firms are required to file all widely disseminated retail communications with FINRA's Advertising Regulation Department during their first year of membership, and all firms are subject to filing requirements for specified retail communications depending on their content.

FINRA Rule 2220 (Options Communications) governs firms' 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.

Findings and Effective Practices

Findings

- **Inadequate Supervision of Firms' Social Media Influencers: Not establishing, maintaining and enforcing a system, including WSPs, reasonably designed to supervise communications disseminated on the firm's behalf by influencers *(e.g.,* not reviewing influencers' videos prior to posting on social media platforms; not retaining those videos).**
- **False, Misleading and Inaccurate Information in Mobile Apps:**
  - Misstating or failing to disclose the risk of loss associated with certain options transactions.
  - Distributing false or misleading promotions through social media and "push" notifications or "nudges" on mobile apps that made promissory claims or omitted material information.
  - Failing to fully explain and clearly and prominently disclose risks, where required by a specific rule or needed to balance promotional claims, associated with options trading, the use of margin and crypto assets.

Emerging Trend: Retail Communications Focused on Registered Index-Linked Annuities

- FINRA's recent retail communications findings related to registered index-linked annuities (RILAs) include:
  - inadequately explaining how RILAs function;
  - insufficiently explaining specialized terms specific to RILAs (*e.g.*, cap rates, buffers);
  - not including risk disclosures (or not including them prominently);
  - not including disclosures regarding fees and changes;
  - making exaggerated, misleading, unwarranted or promissory statements and claims (*e.g.*, exaggerated use of the term "downside protection" in describing buffers); and
  - making hypothetical illustrations that go beyond the sole purpose of showing how RILAs function (*e.g.*, including forward looking rates of return that project the potential future value of investing in a RILA).
- For additional guidance concerning RILAs—including findings, an overview of how these products function and definitions of specialized terms—please see the Annuities Securities Products topic.

Effective Practices

- **Procedures for Mobile Apps:** Maintaining and implementing procedures for the supervision of mobile apps, for example, that confirm:
  - **information and** data displayed to customers **are** accurate; and
  - information about mobile apps' tools and features complies with FINRA's communications and other relevant rules before it is posted to investors.
- **Reasonably Designed Procedures for Digital Communications:** Establishing, maintaining and enforcing procedures for supervision of digital communication channels, including:
  - **Monitoring of New Tools and Features:** Monitoring new communication channels, apps and features available to associated persons and customers;
  - **Defining and Enforcing Permissible and Prohibited Activity:** Clearly defining permissible and prohibited digital communication channels, tools and features, and blocking those prohibited channels, tools and features that prevent firms from complying with their **supervision and** 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; and
  - **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 before resuming use.
  - **Gen AI Technology:**
    - **When using Gen AI technology to generate or otherwise assist in creating communications to customers, reviewing to ensure that these communications comply with applicable federal securities laws and regulations and FINRA rules.**
    - **When using Gen AI technology to create or otherwise assist in creating chatbot communications that are used with investors, ensuring the appropriate supervision of those communications, and retention of those chat sessions, in accordance with SEC and FINRA rules.**
    - **Ensuring that retail communications that mention AI tools, AI services (*e.g.*, portfolio construction, research) or products that rely on AI management accurately describe how these offerings incorporate AI technology and balance the discussion of benefits with appropriate discussion of risks.[28]**
- **Communications Promoting Securities Lending Programs: Ensuring that communications that promote or recommend income sharing programs to retail investors (*e.g.,* fully paid securities lending programs) accurately and clearly disclose the terms and conditions of the program, including fees customers would receive.**

Additional Resources

- FINRA
  - Advertising Regulation Key Topics Page
  - Social Media Key Topics Page
  - **Frequently Asked Questions about Advertising Regulation**, **Supervising Chatbot Communications** **and AI Created Communications**

Reg BI and Form CRS

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. The standard of conduct established by Reg BI cannot be satisfied through disclosure alone.

Separately, whether they make recommendations or not, firms that offer services to retail investors must file and provide retail investors with Form CRS, a brief relationship summary **in a prescribed format** that discloses **important** information about the firm in plain language (*e.g.*, investment services provided, fees, conflicts of interest, legal and disciplinary history of the firms and associated persons).

Findings and Effective Practices

Findings

Reg BI

- **Failure to Comply with Care Obligation:**
  - Failing to conduct a reasonable investigation of offerings prior to recommending them to retail customers (*e.g.,* unable to reasonably evidence due diligence efforts regarding the issuer; relying solely on the firm's past experience with and knowledge of an issuer based on previously completed offerings; **or relying solely on information from the issuer or its affiliate**).[29]
  - **Making recommendations without developing a sufficient understanding of the features and risks of the recommended security or investment strategy involving a security, such as when recommending leveraged and inverse exchange-traded products without understanding holding-period risk[30] or recommending high-risk bonds without understanding bondholders' rights in the event of a default.**
  - Making recommendations of securities or investment strategies involving securities (including account **recommendations**) without a reasonable basis to believe that they were in the best interest of a particular retail customer, **including recommendations of complex or risky products that do not align with the retail customer's investment profile**.
  - Recommending a series of transactions that were excessive in light of retail customers' investment profiles and factors such as high cost-to-equity ratios and high turnover ratios.
  - **Recommending that customers replace or switch existing products (*e.g.*, variable annuities, mutual funds, 529 plans) without understanding or considering associated risks and costs, including as applicable, the imposition of penalties *(e.g.*, surrender charges) and new surrender periods, loss of existing benefits, tax consequences and transaction costs.**
  - **Failing to consider or compare** relevant costs and fees, such as product or account-level fees, when recommending a product or **when determining whether to recommend transactions in a customer's brokerage or advisory account or to recommend transfers of securities between brokerage and advisory accounts**.
  - Not maintaining profile information **collected from** retail customers in accordance with SEA Rule 17a-3(a)(35), thereby undermining the firm's and its associated persons' abilities to demonstrate compliance with the Care Obligation.
  - **Making recommendations of complex or risky products that result in concentrations exceeding limits specified in a firm's policies, or comprising a sizable portion of a retail customer's liquid net worth or securities holdings in a manner that is inconsistent with the retail customer's risk tolerance or investment objectives.**

- **Failure to Comply with Conflict of Interest Obligation:**
  - Not identifying conflicts and disclosing, mitigating, or eliminating, as appropriate, conflicts of interest associated with recommendations of securities transactions or investment strategies involving securities.
  - Not identifying and mitigating (*i.e.*, modifying practices to reduce) conflicts of interest that create an incentive for an associated person to make securities recommendations that place the interests of the associated person or the firm ahead of the interests of the retail customer, including:
    - not properly supervising or enforcing internal policy restrictions on certain types of recommendations (*e.g.*, transactions in affiliated private funds) that are intended to mitigate or eliminate potential conflicts; and
    - not identifying and mitigating potential conflicts regarding revenue or fee-sharing arrangements with fund managers for offerings that were recommended to retail customers.
  - **Not identifying and disclosing all *material* facts concerning *material* conflicts of interest related to an associated person's incentive to recommend particular securities or account types (*e.g.,* an associated person's financial incentive to recommend the opening of new investment accounts at the firm's affiliate or to recommend bonds issued by a company in which the associated person had a significant personal ownership stake, the value of which largely depended on the bond sales).**
  - Not identifying and addressing all potential conflicts of interest relevant to a firm's business model, including, but not limited to, material limitations on securities or investment strategies and conflicts associated with these limitations.
- **Failure to Comply with Disclosure Obligation:**
  - Not providing retail customers with "full and fair" disclosures of all material facts related to the scope and terms of their relationship with these retail 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 roll over qualified accounts);
    - potential conflicts of interest;
    - material limitations in securities offerings; and
    - transaction-based fees that were inconsistent with—and, in some cases, materially higher than—those outlined in Reg BI customer disclosures.
  - Associated persons, firms, or both, improperly using the terms "advisor" or "adviser" in their titles or firm names, even though they lack the appropriate registration **and do not engage in other activities that allow the use of those terms**.
- **Failure to Comply with Compliance Obligation:**
  - Failing to adopt and implement written policies and procedures that are reasonably designed to achieve compliance with Reg BI by, for example, stating the rule requirements but failing to identify how the firm will comply with those requirements (*e.g.,* requiring associated persons to consider costs and reasonably available alternatives when making recommendations, but not specifically addressing or detailing how associated persons should do so).
  - Failing to develop adequate controls or developing adequate controls but not memorializing these processes in their WSPs.
  - Failing to enforce Reg BI procedures or supervisory processes for compliance, such as outlining documentation requirements, and failing to implement any process to confirm associated persons are complying with the firms' requirements **or failing to follow up on red flags (*e.g.*, duplicative rationales documented by the same associated person for different types of customers)**.

- Failing to maintain sufficient systems or controls supporting firms' ongoing trade surveillance to identify potential non-compliance with Reg BI, such as relying on manual review methods that were inconsistently performed or controls that were not reasonable given firms' volume of transactions.
- Failing to conduct adequate or ongoing training of associated persons regarding the use of systems and processes established to support Reg BI compliance.
- Failing to help ensure that recommendations involving variable annuities (VAs) **or RILAs** are compliant with Reg BI (*e.g.*, not adequately collecting and retaining key information on variable annuity transactions; and not sufficiently training **associated persons** and supervisors to determine whether variable annuity **or RILA** exchanges complied with the standards of Reg BI).[31]
- **Failing to have written policies and procedures reasonably designed or enforced with respect to account recommendations, for example, by:**
  - **not being reasonably designed to address recommended transfers of products between brokerage and advisory accounts or rollover recommendations;**
  - **not being reasonably designed to achieve compliance with the capacity disclosure requirement, including the titling restriction;**
  - **not following up on red flags such as identified patterns of account switches by the same associated person; or**
  - **requiring documentation of rationale, but not following up on generic or insufficient rationales.**
- **Failing to have written policies and procedures reasonably designed to achieve compliance with the capacity disclosure requirement, including the titling restriction.**

Form CRS

- **Deficient Form CRS Filings:** Firms' Form CRS filings significantly departing from the Form CRS instructions or SEC guidance by:
  - inaccurately representing the firm's or its associated persons' disciplinary histories, including inappropriate qualifying language to explain disciplinary history;
  - omitting material facts (*e.g.*, description of services offered, limitations of the firm's investment services, incomplete or inaccurate cost disclosures);
  - failing to describe, or inaccurately describing types of compensation and compensation-related conflicts;
  - incorrectly stating that the firm does not provide recommendations; and
  - changing or excluding language required by Form CRS.
- **Failing to Properly Deliver Form CRS:** Failing to deliver or not creating a record of the date on which the firm provided each Form CRS to each retail investor, including **failure to deliver** Form CRS before such retail investor opened an account.
  - If the relationship summary is delivered electronically, failing to present it prominently in the electronic medium and make it easily accessible for retail investors (*e.g.,* by solely placing a link to the Form CRS in an email footer below the signature line; by including the Form CRS among other disclosures in a zip file attachment without any mention of the Form CRS in the email).
- **Failing to Properly Post Form CRS:** 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); and **failing to post Form CRS on financial professionals' doing business as (DBA) websites when the firm offers services to retail investors through the financial professional and the firm's services are offered or promoted through the DBA website.**

- **Failing to Adequately Amend Form CRS:** Firms not in compliance with Form CRS in relation to material changes because they:
  - failed to timely re-file **with an exhibit highlighting the changes** in the Central Registration Depository (CRD) (*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 investors (*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 and Deliver Form CRS:** Incorrectly assuming 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.*, **only** selling investment company products held directly by an issuer, **servicing** self-directed accounts **or otherwise not making recommendations**).

Effective Practices

Care Obligation

- **Costs and Reasonably Available Alternatives:** Including in procedures and processes specific factors related to evaluating costs and reasonably available alternatives to recommended products, including but not limited to:
  - providing clear guidance to associated persons making recommendations on how to evaluate costs and reasonably available alternatives, such as by:
    - **advising that reasonably available alternatives be considered before a recommendation has been formulated;**
    - using worksheets, in paper or electronic form, to compare costs and reasonably available alternatives;
    - creating notes or documents in a similar format to evaluate recommended transactions and provide information on the retail customer's financial situation, needs and goals (and substantiate why that specific recommendation was in the retail customer's best interest);
    - specifying the relevant factors to consider when evaluating costs (*e.g.*, deferred sales charges) and reasonably available alternatives (*e.g.*, similar investment types or less-complex or less-risky products available at the firm);
    - updating client relationship management (CRM) tools to automatically compare recommended products to reasonably available alternatives; or
    - **ensuring that any technology used to generate recommendations is coded to consider costs on both affiliated and non-affiliated investment products offered by the firm**;
  - setting forth clear supervisory processes that address reviews and firm-required documentation;
  - sampling recommended transactions to evaluate how costs and reasonably available alternatives were considered;
  - outlining firm documentation practices; and
  - establishing limitations on complex or higher-risk products, such as by using firm concentration limits or minimum liquid net worth requirements.
- **Heightened Scrutiny of Complex or Risky 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; and
  - applying heightened supervision to recommendations of products, or investment strategies involving securities, that are **complex or risky**, or limiting such recommendations to specific customer types.

Conflict of Interest Obligation

- **Policies and Procedures:** Establishing and implementing policies and procedures to address conflicts of interest by:
  - using 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;
  - revising commission schedules for recommendations within product types to flatten the percentage payout rate to employees; and
  - broadly prohibiting all sales contests, regardless of whether they are required to be eliminated under Reg BI.

Disclosure Obligation

- **Implementing Systems Enhancements for Recording the Date of Delivery of Required Customer Documents: Maintaining a record for** delivering Form CRS and Reg BI-related documents to retail customers in a timely manner by:
  - automating mechanisms to evidence delivery of Form CRS and other relevant disclosures; and
  - memorializing delivery of required disclosures at the earliest triggering event.
- **Providing Clear Disclosure on Account Type Recommendations**: Providing retail customers with clear, accessible materials that allow them to compare the features, benefits and costs of certain account type recommendations (*e.g.*, rollovers).

Compliance Obligation

- **Implementing New Surveillance Processes:** Monitoring associated persons' compliance with Reg BI by:
  - conducting reviews to confirm that their recommendations meet Care Obligation requirements, including system-driven alerts or trend criteria to identify:
    - account type or rollover or transfer recommendations that may be inconsistent with a retail customer's best interest;
    - products that are high risk, high cost, complex or represent a significant conflict of interest;
    - excessive trading; and
    - sale of same product(s) to a high number of retail customers; and
  - 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.
- Incorporating Reg BI-specific reviews into the branch exam program, in addition to other ongoing monitoring and surveillance.
- Focusing on areas such as documenting Reg BI compliance and following the firms' Reg BI **written policies and procedures** (as part of overall Reg BI compliance efforts).

Additional Resources

- FINRA
  - SEC Regulation Best Interest Key Topics Page
  - **2024 FINRA Annual Conference: The Progression of Regulation Best Interest and Form CRS**
  - *Regulatory Notice* 23-20 (FINRA Highlights Available Guidance and Resources Related to Regulation Best Interest)

- SEC
  - Regulation Best Interest, Form CRS and Related Interpretations
  - **Frequently Asked Questions on Regulation Best Interest**
  - Frequently Asked Questions on Form CRS
  - Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Care Obligations (April 30, 2023)
  - Observations from Broker-Dealer Examinations Related to Regulation Best Interest (January 30, 2023)
  - Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Conflicts of Interest (August 3, 2022)
  - Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors (March 30, 2022)
  - Staff Statement Regarding Form CRS Disclosures (December 17, 2021)
  - You may submit a question by email to tradingandmarkets@sec.gov; additionally, you may contact the SEC's Division of Trading and Markets' Office of Interpretation and Guidance at (202) 551-5777

Private Placements

Regulatory Obligations

In *Regulatory Notice 23-08* (FINRA Reminds Members of Their Obligations When Selling Private Placements), FINRA noted the obligations of firms that recommend private placements to conduct a reasonable investigation of those securities under Reg BI for recommendations to retail customers and FINRA Rule 2111 (Suitability) for recommendations to non-retail customers, as well as other obligations that could apply even in the absence of a recommendation, including FINRA Rules 2210 (Communications with the Public), 3110 (Supervision), 3280 (Private Securities Transactions of an Associated Person), 5122 (Private Placements of Securities Issued by Members) and 5123 (Private Placements of Securities).

Regulatory Notice 23-08 (FINRA Reminds Members of Their Obligations When Selling Private Placements) updated and supplemented guidance published under *Regulatory Notice 10-22* (Obligations of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings) and reiterated firms' obligation, when recommending a security, to conduct a reasonable investigation of the security by evaluating, at a minimum, "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."

Additionally, FINRA Rules 5122 and 5123 require firms to timely file with FINRA offering documents and information for the private placements they offer or sell, including retail communications used by the broker-dealer to promote or recommend an offering, unless there is an available exemption.

Findings and Effective Practices

Findings

- **Inadequate Filings Procedures:** Not maintaining policies and procedures, processes and supervisory programs to comply with filing requirements; resulting in a failure to file or untimely filings (with, in some cases, delays lasting as long as six to 12 months after the offering's first date of sale); and **misapplying filing exemptions under FINRA Rule 5123(b) (*e.g.*, misunderstanding the accredited investor exemption under this Rule, and thus not making required filings for some offerings sold to accredited investors).**
- **Failure to Comply with Reg BI's Conflict of Interest Obligation:** Not adequately identifying, disclosing and, where required, mitigating conflicts of interest associated with recommendations of private placements.[32]

- **Failing to Conduct Reasonable Investigation:** Failing to fulfill reasonable basis obligations prior to recommending private placements to retail investors, by:
  - failing to conduct an appropriate level of research, particularly when there is a lack of operating history;
  - relying solely on the firm's past experience and knowledge with an issuer based on previously completed offerings;
  - failing to inquire into, analyze and resolve red flags identified during the reasonable investigation process or in third-party due diligence reports; and
  - failing to conduct a reasonable investigation of the issuer, the individuals involved in its management or other "covered persons" under Reg D.
- **Failure to Evidence Due Diligence:** Failing to maintain records of, or otherwise evidence or reasonably explain, due diligence efforts into issuers' financial condition, operations, representations of past performance and involvement in litigation.
- **Failure to Comply with Reg BI's Care Obligation: Incorrectly purporting to not make recommendations of private placements, or claiming that the issuer is making the recommendations, despite firms' representatives engaging in communications with customers that include a "call to action" concerning the particular security and that are individually tailored to the customer. As a result, the representative did not exercise reasonable diligence, care and skill in making such recommendations.**
- **Failure to Comply with SEC Rules Regarding Contingency Offerings: Participating in a contingency offering without meeting the requirements of SEA Rules 10b-9 and 15c2-4, in particular when the contingency terms are amended during the offering (*e.g.,* significantly reducing the minimum contingency amount).**

Emerging Trend: Private Placements Offerings of Pre-IPO Securities

- FINRA has observed that certain parties involved in private placements focused on pre-IPO shares have engaged in potentially fraudulent activity. Specifically, FINRA has observed instances in which firms have made material misrepresentations and omitted material information in connection with the recommendations of private placement offerings of pre-IPO securities (*e.g.*, not disclosing potential selling compensation).
- FINRA has also observed that firms have often failed to conduct reasonable due diligence and failed to confirm or obtain sufficient documentation that the issuer actually held or had access to the shares it purported to sell.
- For additional guidance—including best practices for establishing and supervising a reasonable investigation process—please see *Regulatory Notice* 23-08.

Effective Practices

- **Private Placement Checklist: Amending due diligence checklists to account for specific types of private placements with unique risk factors or conditions that may impact whether they are in the best interest of retail customers.**
- **"Bad Actor" Questionnaires:** Reviewing "Bad Actor" forms or similar questionnaires at both the issuer level (*e.g.*, Directors' and Officers' Questionnaires) and placement agent level (*e.g.*, registered representative questionnaires) to support compliance with Rules 506(d) and 506(e) of Regulation D.
- **Independent Research:** Conducting and documenting independent research on material aspects of the offering by, for example;
  - verifying representations and claims made by the issuer that are crucial to the performance of the offering (*e.g.*, costs projected to execute the business plan, projected timing and overall rate of return for investors);

- 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.

- **Review of Offering Terms:** Reviewing offering terms to determine if they are reasonably structured for compliance with applicable rules (*e.g.*, analyzing the escrow arrangements and termination provisions in contingency offerings).
- **Ongoing Use of Proceeds Assessment: Upon reasonably learning of material changes to the offering—or the issuer's business during the offering—evaluating factors that may alter the issuer's intended use of proceeds.**
- **Training: Requiring that firms' representatives complete targeted, in-depth training about the firms' policies, process and filing requirements prior to recommending an offering.**

Additional Resources

- FINRA
  - Private Placements Key Topics Page
  - SEC Regulation Best Interest Key Topics Page
  - Report Center—Corporate Financing Report Cards
  - *Regulatory Notice 23-08* (FINRA Reminds Members of Their Obligations When Selling Private Placements)
- SEC
  - Regulation Best Interest, Form CRS and Related Interpretations
  - Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings and Related Disclosure Requirements (September 19, 2013)

Annuities Securities Products

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 recommendations of variable annuities and registered index-linked annuities (RILAs) (referred to collectively below as "annuity" or "annuities").

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. The standard of conduct established by Reg BI cannot be satisfied through disclosure alone.

In addition, FINRA Rule 2330 (Members' Responsibilities Regarding Deferred Variable Annuities) **continues to apply to** recommended purchases and exchanges of deferred variable annuities **(referred to below as variable annuities)**. FINRA Rule 2330, **among other things,** requires member firms to establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the rule. Member 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.

Emerging Trend: RILAs

- The market for RILAs has grown significantly in recent years, with annual RILA sales of $47.4 billion in 2023 alone, 15 percent higher than in the prior year, and more than quintupling since 2017.[33]
- A RILA is one of several types of annuity contracts offered by insurance companies. An investor in a RILA allocates purchase payments to one or more investment options under which the investor's returns (both gains and losses) are based at least in part on the performance of an index or other benchmark over a set period of time known as a crediting period.[34]
- RILAs are complex financial products sold to retail investors, and have certain characteristics—such as those listed below—that can impact RILAs' performance:
  - unlike other investments, such as mutual funds, RILA investors periodically realize gains and losses at the end of each crediting period, essentially forcing liquidation (the sale of the investment option) at a specified date, even if market conditions are unfavorable;[35]
  - the performance of an index-linked option may be based on a "price return" index rather than a "total return" index, which typically results in a lower return since a price return index does not reflect reinvestment of dividends of the underlying securities;[36]
  - while most RILAs have no explicit fees (other than surrender charges), a RILA's bounded return structure is a feature of RILA contracts that, generally, will limit the investor's gains if the performance of the index goes up in value, as well as limit the investor's losses if the performance of the index goes down in value.[37] This bounded return structure requires investors to agree to tradeoffs that come with their own economic costs and benefits, typically by:
    - limiting the ability of investors to take certain actions during the crediting period (*e.g.*, surrender, withdrawal, payment of a death benefit, start of annuity payments, change of investment) without bearing adjustments,[38] which can be negative and can result in significant loss;
    - limiting investors' abilities to participate in upside index performance (through features such as "cap rates"[39] or "participation rates"[40]); and
    - limiting investors' losses if the performance of the index goes down in value (through features such as "buffers"[41] or "floors"[42]).
- For additional information, please see the SEC's Proposing Release and Adopting Release concerning recent rulemaking on RILAs.

Findings and Effective Practices

Findings

- **WSPs: Failing to have reasonable supervisory procedures to achieve compliance with FINRA Rule 2330 or reasonably designed written policies and procedures pursuant to Reg BI, as applicable, with respect to:**
  - **recommendations of annuities to help ensure that customers are not over-concentrated in variable annuities or RILAs in light of their holdings in other illiquid asset classes;**
  - **consideration of the customer's age in assessing whether the recommendation to purchase an annuity is in the retail customer's best interest;**
  - recommendations related to issuer buyout offers (*e.g.*, registered representatives' recommendations that investors surrender the contract pursuant to an insurance company's offer to generate an exchange or new purchase);
  - registered representatives' recommendations of additional deposits into existing variable annuity contracts, including review of any applicable disclosure, **new** surrender **periods** related to this transaction and rationale for the addition;

- detecting rates of exchanges that may indicate a violation of FINRA Rule 2330 or Reg BI (*e.g.*, recommending the same replacement of a variable annuity to many customers with different investment objectives); and
- conducting training for registered representatives and supervisors regarding how to assess and compare costs and fees, surrender charges and long-term income riders to determine whether exchanges complied with the standards of FINRA Rule 2330 and Reg BI.

- **Exchanges: Recommending variable annuity exchanges that were unsuitable for, or not in the best interest of, retail customers where the exchanges were inconsistent with the customer's investment objectives and time horizon and resulted in, among other consequences:**
  - **increased mortality and expense, administration, and rider fees to the customer;**
  - **the imposition of** surrender fees for early liquidation of the customer's existing product**; or**
  - **the loss of material benefits (*e.g.*, loss of a living benefit rider).**
- **Reg BI Care Obligation Violation for Recommended Surrenders/Withdrawals of Variable Annuities and Purchases of RILAs:**
  - **Recommending without a reasonable basis that customers surrender existing annuities and then use the proceeds to purchase RILAs.**
  - **Failing to consider whether the purchases, even if done as a 1035 exchange,[43] were in the particular customers' best interests in light of their investment profiles.**
- **Reasonably Available Alternatives:** Pursuant to Reg BI, insufficient consideration of reasonably available alternatives to the recommended annuity purchase, surrender or exchange.
- **False or Misleading Documentation: Submitting paperwork for recommended variable annuities transactions that contain misrepresentations or omissions (*e.g.*, falsely stating the transaction was not funded by another variable annuity; understating surrender charges; not indicating when customers had surrendered or exchanged a variable annuity in the past 36 months).**
- **Poor and Insufficient Data Quality:** Not collecting and retaining **records** on annuity transactions, particularly in connection with replacement/exchange transactions; relying on processes for data collection and retention in situations where the volume of annuity transactions renders these processes ineffective; and failing to address inconsistencies in available **transaction** data for annuities (*e.g.*, with respect to identifying and labeling replacements/exchanges), as well as data formats and reporting processes.

Effective Practices

- **Applying Heightened Policies and Procedures to RILA Recommendations: Incorporating into a firm's WSPs and written policies and procedures heightened policies and procedures for recommendations of RILAs, such as the explicit requirements that apply to variable annuities under FINRA Rule 2330, including, but not limited to requiring:**
  - **a registered representative to document and sign his or her rationale for a recommendation of a RILA;**
  - **a registered principal to review and determine whether he or she approves of a recommended purchase or exchange of a RILA;**
  - **a reviewing principal to document and sign the basis for his or her approval (or rejection) of the recommendation;**
  - **the gathering of information regarding whether customers have had RILA exchanges (or replacements of VAs with RILAs and vice versa) within the preceding 36 months; and**
  - **implementation of surveillance procedures to determine if any of the member's associated persons have rates of effecting RILA exchanges (or replacements of VAs with RILAs and vice versa) that raise for review whether such exchanges evidence conduct inconsistent with Reg BI.**

- **Addressing RILA Features: Providing guidance to associated persons on how to consider whether RILAs (including investment options) and particular features of a RILA are in a retail customer's best interest, including:**
  - **the manner in which interest is calculated and credited;**
  - **the bounded return structure;**
  - **automatic renewals that occur at the end of a crediting period; and**
  - **applicable contract adjustments, including interim value adjustments (IVAs), market value adjustments (MVAs) or limits on the RILA's performance.**
- **Exchange Disclosures: Using exchange disclosure forms to provide the customer with meaningful information about the advantages and disadvantages of the recommended exchange, including:**
  - **a comparison of the fees (and in the case of RILAs, the economic costs of their bounded return structure as well as IVAs and MVAs) and surrender periods of the existing and new products;**
  - **disclosure of the loss of any benefits with the existing product (including a benefit base that exceeds the contract value); and**
  - **the representative's rationale for the exchange.**
- **Account Recommendations: Providing guidance on how to consider account types and costs when potentially recommending broker-dealer versus advisory annuity contract classes.**
- **Automated Surveillance:** Using automated tools, exception reports and surveillance to review annuity exchanges; and implementing second-level supervision of supervisory reviews of exchange-related exception reports and account applications.
- **Detailed Rationales for Exchanges:** Confirming that registered representatives'—and, where applicable, supervisory principals'—written rationales for annuity exchanges for each customer address the specific circumstances for each customer and do not inappropriately replicate rationales provided for other customers; and requiring supervisory principals to verify the information in these rationales that registered representatives provide, including product fees, costs, rider benefits and existing product values.
- **Review Thresholds:** Standardizing review thresholds for rates of annuity exchanges; and monitoring for emerging trends across registered representatives, customers, products and branches.
- **Data Integrity:** Engaging with insurance carriers (affiliated and non-affiliated) and third-party data providers (*e.g.*, Depository Trust and Clearing Corporation (DTCC), consolidated account report providers) to confirm their annuity data integrity (including general product information, **contract** class, riders and exchange-based activity).
- **Data Acquisition:** Establishing a supervisory system that collects and uses key transaction data, including, but not limited to:
  - transaction date;
  - representative 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;
- **contract** class; and
- commissions.

- **Data Analysis:** Considering the following data points when conducting a review of a recommended 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;
  - whether the customer has had another annuity exchange within the preceding 36 months;
  - living benefit value, death benefit value or both, that was forfeited;
  - surrender charges incurred; and
  - any additional benefits surrendered with forfeiture.

Additional Resources

- FINRA
  - Variable Annuities Key Topics Page
  - SEC Regulation Best Interest Key Topics 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)**

- SEC
  - Registration for Index-Linked Annuities and Registered Market Value Adjustment Annuities, Final Rule, Securities Act Release No. 11294 (July 1, 2024), **89 FR 59978** (July 24, 2024)
  - Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities, Proposed Rule, Securities Act Release No. 11250 (Sept. 29, 2023), **88 FR 71088** (Oct. 13, 2023)
  - **Investor Testing Report on Registered Index-Linked Annuities (September 2023)**
  - Regulation Best Interest, Form CRS and Related Interpretations

Market Integrity

Consolidated Audit Trail (CAT)

Regulatory Obligations

FINRA and the national securities exchanges have adopted rules requiring their members to comply with SEA Rule 613 and the CAT NMS Plan, 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) **notes that firms' WSPs also must be reasonably designed to ensure that the data reported by them or on their behalf is transmitted in a timely fashion and that it is complete and accurate.**

Findings and Effective Practices

Findings

- **Incomplete Submission of Reportable Events:** Failing to report certain Reportable Events, as defined by CAT, in a timely manner to the Central Repository (*e.g.*, new order events, route events, execution events).
- **Failure to Repair Errors Timely:** Not repairing errors by the T+3 correction deadline.
- **Failure to Submit Corrections:** Not submitting corrections for previously inaccurately reported data, including data that did not generate error feedback from CAT.
- **Inaccurate or Incomplete Reporting of CAT Orders:** Submitting information that was incorrect, incomplete or both to the Central Repository.
- **Unreasonable Supervision:**
  - Not establishing and maintaining reasonable WSPs or supervisory controls regarding CAT reporting and clock synchronization that are performed by **the firm**, third-party vendors, **or both**.
  - **Not implementing an accuracy review (as described in *Regulatory Notice* *20-31* (FINRA Reminds Firms of Their Supervisory Responsibilities Relating to CAT)).**
  - **Not using a reasonable sample size when selecting firm CAT reports for review.**
  - **Not supervising Reporting Agents that report to CAT on the firm's behalf.**
  - **Not promptly remediating CAT reporting issues when brought to the firm's attention either through its own reviews or regulatory inquiries from FINRA.**
- **Recordkeeping:** Not maintaining **underlying books and records to support transactional** data reported to CAT.

Effective Practices

- **Mapping Internal Records to CAT-Reported Data:** Maintaining a "map" that shows how the firm's internal records and blotters correspond to various fields reported to CAT.
- **Archiving CAT Feedback:** Archiving CAT feedback within a 90-day window so that firms can submit corrections, if necessary.
- **CAT Supervision:** Implementing WSPs requiring a comparative review of CAT submissions versus firm order and trade records (including for firms that rely on third-party submitters), conducting a daily review of the CAT Reporter Portal, regardless of the error rate percentage; utilizing CAT Report Cards and CAT FAQs to design an effective and reasonable supervision process; and, when relying on a CAT reporting agent, maintaining a written agreement that specifies the respective functions and responsibilities for exception management and error correction.

- **CAT Clock Synchronization:** When relying on third-party, non-broker-dealer vendors for synchronization of business clocks, obtaining synchronization logs daily from such parties and reviewing them to ensure that the clock drifts are within acceptable thresholds (*i.e.*, 50 milliseconds).[44]
- **Customer and Account Information System (CAIS) Supervision:** Establishing reasonable supervisory processes and procedures that address, for example:
  - monitoring both the CAIS Reporter Portal and CAIS notifications for data formatting and inconsistencies;
  - monitoring that customer and account information is reported in an appropriately secure manner pursuant to CAT reporting requirements (*e.g.*, customer input identifiers are not submitted to CAT or CAIS unless they have been properly transformed into a "hashed" Transformed Input ID (TID) prior to submission; customer account identifiers (FDIDs) do not reflect actual account numbers);
  - confirming that CAIS data is consistent with prior submissions for the same customer; and
  - repairing CAIS inconsistencies within the required time period (*i.e.*, no later than 5 p.m. ET on the third CAT Trading Day after the Customer or Account Information became available to the firm).
- **Self-Reporting:** When your firm discovers CAT reporting issues, self-reporting them via the **appropriate form (available in the Forms section of the CAT NMS Plan website)** or through the FINRA CAT Help Desk.

CAIS Reporting Obligations (Updated for 2025)

- **As of May 31, 2024, all Industry Members (Large and Small) must be fully compliant with the CAIS reporting obligations set forth in the CAT Reporting Customer and Account Technical Specifications for Industry Members-Full CAIS.**
- Firms can find the latest updates and additional information related to CAIS reporting and the compliance schedule on the CAT NMS Plan website.

Additional Resources

- FINRA
  - Consolidated Audit Trail (CAT) Key Topics Page
  - *Regulatory Notices*
    - *Regulatory Notice 20-41* (FINRA Amends Its Equity Trade Reporting Rules Relating to Timestamp Granularity)
    - *Regulatory Notice 20-31* (FINRA Reminds Firms of Their Supervisory Responsibilities Relating to CAT)
    - *Regulatory Notice 17-09* (The National Securities Exchanges and FINRA Issue Joint Guidance on Clock Synchronization and Certification Requirements Under the CAT NMS Plan)
- CAT NMS Plan Website
- CAT NMS Clock Synchronization

Data Integrity and Timeliness Issues in Municipal Underwriting Filings

- MSRB Rule G-32 (Disclosures In Connection With Primary Offerings) requires municipal underwriters to provide certain data about primary offerings of municipal securities (*e.g.*, offering type, issuer name and description, security information, type of disclosure document, continuing disclosure information) to the Municipal Securities Rulemaking Board's (MSRB) Electronic Municipal Market Access (EMMA)[45] system within specific timeframes.
- Firms that act as a lead or sole underwriter of municipal securities offerings may consider these common issues concerning the accurate, complete and timely submission of Form G-32 data when evaluating their related supervisory processes and procedures:
  - not submitting Form G-32 data within the timeframes required by MSRB Rule G-32(b)(i)(A);
  - submitting inaccurate data (*e.g.,* formal award time and date, retail order period indicator);
  - submitting data in incorrect fields (*e.g.*, inaccurately reporting that both issuers and obligors had entered into continuing disclosure agreements);
  - submitting inaccurate offering dates and times of first execution for remarketings that are considered "new money;"
  - omitting names of key stakeholders (*e.g.,* syndicate members, municipal advisors);
  - not correctly identifying advance refundings;
  - not correctly identifying limited offerings exempt from SEA Rule 15c2-12; and
  - not checking data prepopulated from the New Issue Information and Dissemination Service (NIIDS) for accuracy and completeness.[46]
- Effective practices for reporting Form G-32 data include:
  - requiring supervisory review of all Form G-32 data prior to submission (including the prepopulated data from NIIDS);
  - periodically reviewing prior data submissions to identify potential areas for improvement;
  - maintaining a documented process for making timely and accurate Form G-32 data submissions; and
  - training firm personnel on Form G-32 submission requirements, timeframes and terminology (including the use of EMMA's Dataport system).
- For additional guidance concerning Form G-32 data integrity, please see the MSRB's Frequently Asked Questions About Form G-32 and the EMMA Document Submission page.

Customer Order Handling: Best Execution and Order Routing Disclosures

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 firm and persons associated with a 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. A firm must have procedures in place to ensure it conducts "regular and rigorous" reviews of the execution quality of its customers' orders if it doesn't conduct an order-by-order review.[47] MSRB Rule G-18 (Best Execution) sets forth similar obligations with respect to transactions in municipal securities.

Best execution obligations apply to any firm that receives customer orders for purposes of handling and execution, including firms that receive customer orders from other firms for handling and execution.[48] These obligations apply whether a firm acts in a principal or in an agency capacity. A firm cannot transfer its duty of best execution to another person. Additionally, a firm that routes all its customer orders to another firm must either **conduct its own regular and rigorous review of the execution quality received, or periodically review the statistical results and rationale of the other firm's regular and rigorous** review of execution quality.

Relatedly, 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.

Recently Adopted FINRA Rule 6151

- On June 30, 2024, FINRA Rule 6151 (Disclosure of Order Routing Information for NMS Securities) took effect.
- Firms are now required to submit to FINRA for centralized publication the order routing reports required under SEC Rule 606(a) (Rule 606(a) Reports).[49]
- For additional guidance, please see *Regulatory Notice 24-05* (FINRA Adopts Amendments to Improve the Accessibility of Order Routing Disclosures for NMS Securities).

Findings and Effective Practices

Findings

Best Execution

- **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, **including ATSs and additional sources of liquidity**; failing to modify routing arrangements or justify why routing arrangements are not being modified; and using routing logic that is not based on execution quality.
- **Unreasonable "Regular and Rigorous Reviews":** Not conducting periodic "regular and rigorous reviews" or, when conducting such reviews, not considering certain execution quality factors set forth in Rule 5310, Supplementary Material .09.
- **No Review of Certain Order Types:** Not conducting adequate reviews on a type-of-order basis, including, for example, for market, marketable limit, or non-marketable limit orders.
- **Securities with Limited Quotations or Pricing Information: Failing to establish procedures with respect to trading in securities with limited quotations or pricing information as set forth in Rule 5310, Supplementary Material .06, including documenting compliance with those policies and procedures.**

Order Routing Disclosures

- **Inaccurate Quarterly Reports:** Publishing incomplete or otherwise inaccurate information in the quarterly report on order routing, such as:
  - inaccurately classifying orders (*e.g.*, classifying orders as "other orders" without considering whether such orders involve a customer request for special handling);[50]
  - incorrectly stating that the firm does not receive payment for order flow (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);
- reporting only held orders in listed options, instead of both held and not held orders;
- inaccurately identifying reported execution venues as "Unknown;"
- inaccurately identifying an entity as an execution venue when that entity does not execute trades (*e.g.*, identifying a routing broker-dealer as an execution venue, where the broker-dealer re-routes but does not execute orders; or an 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 the firm's 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.

▶ **Incomplete Disclosure When Incorporating by Reference:** Incorporating by reference another firm's Rule 606(a)(1) quarterly report with incomplete disclosure of:
- the firm's relationship with the referenced firm, including the clearing or execution relationship;
- the amount and type of order flow routed to the referenced firm;
- the material terms of PFOF received from the referenced firm;
- payment from any profit-sharing relationship received from the referenced firm; and
- transaction rebates received from the referenced 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).[51]

▶ **Not Held Customer Reports:** Failing to provide Rule 606(b)(3) Not Held reports to customers in a timely manner.

▶ **Insufficient WSPs:** Either not establishing or not maintaining WSPs reasonably designed to achieve compliance with the requirements of Rule 606, including:
- not updating Disclosure of Order Routing Information WSPs to include requirements detailed in Rule 606(a)(1) or Rule 606(b)(3);
- not describing the steps taken to review whether the firm has verified the integrity of information sent to, or received from, their third-party vendor — or not stating how the review would be evidenced;
- not articulating a supervisory method of review to verify the accuracy, format, completeness, timely processing, and details of the Rule **606 (b)(1) and (b)(3) reports**, if requested, as well as documenting the performance of that review; and
- when incorporating by reference another firm's Rule 606(a)(1) quarterly report, not examining the report and having a reasonable basis to believe that the report does not materially misrepresent the order routing practices.

Effective Practices

Best Execution

- **Supervision of Order Flow:** Ensuring supervisory procedures, systems and controls address the execution of the entirety of the firm's marketable order flow, including order types such as activated stop orders, all or none orders, and odd lot orders.
- **Monitoring Orders:**
  - Monitoring the handling of marketable orders of all types fully and promptly, including market orders, marketable limit orders, activated stop orders, all or none orders, odd lot orders, marketable orders in illiquid securities, and marketable orders in preferred securities.
  - **If your firm relies on the regular and rigorous review of execution quality conducted by an executing firm, consolidator or other recipient handling customer orders, reviewing to ensure that the statistical results and rationale of the executing firm's, consolidator's or other route recipient's review are fully disclosed to you, and periodically reviewing both the methodology and the results of the review.**
- **Exception Reports:** Using exception reports and surveillance reports to support the firm's efforts to meet their best execution obligations.
- **Full and Prompt Execution of Marketable Customer Orders:** Regularly evaluating the firm's thresholds used to generate exceptions as part of the firm's supervisory systems designed to achieve compliance with the firm's "full and prompt" obligations; and modifying such thresholds to reflect current promptness standards for marketable order execution, including statistics available from FINRA, other relevant indicators of industry standards, and the firm's internal data.
- **PFOF Order Handling Impact Review:** Reviewing how PFOF affects the firm's order-handling process, including the following factors:
  - any explicit or implicit contractual arrangement to send order flow to a third-party broker-dealer;
  - the 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 on a quarterly or more frequent basis (such as monthly), depending on the firm's business model, that consider the potential execution quality available at various trading centers, including those to which a firm does not send order flow.
- **Support of Analysis:** Being prepared to explain and evidence the firm's best execution analysis, including internalized orders, on a "regular and rigorous" or order-by-order basis, as applicable.
- **Continuous Updates:**
  - Updating WSPs and best execution analysis to address market and technology changes.
  - **Maintaining and regularly reviewing firm policies and procedures to comply with FINRA Rule 5310 and updating or revising such policies and procedures, as necessary.**
- **Best Execution Committees:** Establishing committees that meet quarterly or more frequently to conduct "regular and rigorous" reviews and determine, if necessary, to modify the firm's order routing and execution arrangements.

Order Routing Disclosures

- **Supervision:** Conducting regular, periodic supervisory reviews to ensure that:
  - public quarterly reports and customer-specific order disclosure reports are:
    - accurate (*e.g.*, assuring that per-venue disclosures of net aggregate PFOF and other payments are accurately calculated); and
    - complete (*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).
  - **SEC Rule 606(a) Reports are** provided to FINRA, in the manner prescribed by FINRA, within the same time and in the same formats that such report is required to be made publicly available pursuant to Rule 606(a), and that:
    - **erroneous or rejected submissions to FINRA are corrected and resubmitted;**
    - **hyperlinks in reports submitted to FINRA are operational;**
    - **reports made publicly available by firms are consistent with the reports submitted to FINRA; and**
    - **complete and current clearing firm information is submitted to FINRA (for introducing firms that incorporate by reference their clearing firm(s)' Rule 606(a) Reports).**
- **Due Diligence:**
  - **Identifying Execution Venues:** Routing-only firm (*i.e.*, a broker-dealer that re-routes but does not execute orders) confirming it is not inaccurately reported as an execution venue.
  - **Third-Party Vendors:** Assess the accuracy of public quarterly reports and customer-specific order disclosure reports provided by third-party vendors by, for example:
    - reviewing the content of reports;
    - comparing order samples against third-party vendor-provided information; and confirming with the third-party vendor that all appropriate order information is being received (particularly when the firm has complex routing arrangements with execution venues).

Additional Resources

- FINRA
  - *Report Center*
    - Best Execution Outside-of-the-Inside Report Card
    - Equity Report Cards
    - Market Order Timeliness Statistical Report
- **FINRA Rule 6151—Centralization of SEC Rule 606(a) Reports**
- *Regulatory Notices*
  - ***Regulatory Notice 24-05*** **(FINRA Adopts Amendments to Improve the Accessibility of Order Routing Disclosures for NMS Securities)**
  - *Regulatory Notice 22-04* (FINRA Reminds Member Firms of Obligation to Execute Marketable Customer Orders Fully and Promptly)
  - *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 Firm Best Execution Obligations And Provides Guidance to Members Concerning Compliance)

- SEC
  - **Responses to Frequently Asked Questions Concerning Rule 606 of Regulation NMS (updated June 26, 2024)**
  - Division of Examinations Risk Alert: Observations Related to Regulation NMS Rule 606 Disclosures (November 10, 2022)
  - SEC Adopts Rules That Increase Information Brokers Must Provide to Investors on Order Handling (November 2, 2018)

SEC Amends Standards for Covered Clearing Agencies for U.S. Treasury Securities

- In December 2023, the SEC adopted rule amendments that impose requirements on clearing agencies that provide central counterparty services for U.S. Treasury securities ("covered clearing agencies").[52]
- Among other things, the amendments require covered clearing agencies to have policies and procedures that:
  - require their direct participants[53] to submit for clearing certain eligible secondary market transactions in U.S. Treasury securities;
  - calculate, collect and hold margin for their direct participants' proprietary transactions in U.S. Treasury securities separately from transactions submitted on behalf of indirect participants[54]; and
  - ensure that the covered clearing agencies have appropriate means to facilitate access to clearance and settlement services of all eligible secondary market transactions in U.S. Treasury securities, including those of indirect participants.
- The requirements also amend the broker-dealer customer protection rule to permit margin required and on deposit at a covered clearing agency for U.S. Treasury securities to be included as a debit in the customer and PAB reserve formulas, subject to certain conditions.
- The amendments regarding changes to improve covered clearing agencies' risk management practices, protection of customer assets, and access to clearing and settlement services have a compliance date of March 31, 2025.
- After that time, compliance by the direct participants of a U.S. Treasury securities covered clearing agency with the requirement to clear eligible secondary market transactions is required by December 31, 2025, and June 30, 2026, respectively, for cash and repo transactions.

Regulation SHO—Bona Fide Market Making and Close-Out Requirements

Regulatory Obligations

Rules 203(b) (Short sales) and 204 (Close-out requirement) of Regulation SHO provide exceptions for bona fide market making activity. The SEC has provided guidance on what constitutes "bona fide market making activities" as well as examples of what does not. Firms must also confirm and be able to demonstrate that any transaction for which they rely on a Regulation SHO bona fide market making exception qualifies for the exception, consistent with Regulation SHO and guidance.[55] For example, reliance on and compliance with an exchange's market making designation and quoting requirements does not *per se* qualify a market maker for the bona fide market maker exception. Additionally, a bona fide market maker must regularly and continuously place quotations in a quotation medium on both the bid and ask side of the market. Only market makers engaged in bona-fide market making in the security at the time they effect the short sale may rely on the exception.[56]

Rule 204 of Regulation SHO requires that firms close out fails-to-deliver within established timeframes by purchasing or borrowing the relevant security by market open on the relevant close out date. Pursuant to SEC guidance, a firm may use exchange-traded funds (ETF) conversion activity to meet the purchase requirement of the rule under certain circumstances as detailed in a 2017 SEC No-Action Letter. This position is limited to ETF conversion activity and **does not extend to other conversion activity, such as** American Depositary Receipt (ADR) conversions, to comply with the purchase requirements of Rule 204.

Findings and Effective Practices

Findings

- **Non-Bona Fide Market Making:** Failing to distinguish bona fide market making from other proprietary trading activity that is not eligible to rely on Regulation SHO's bona fide market making exceptions, which includes:
  - quoting only at maximum allowable distances from the inside bid/offer (*e.g.*, using peg orders);
  - posting quotes at or near the inside ask but not at or near the inside bid;
  - only posting bid and offer quotes near the inside market when in possession of an order; and
  - displaying quotations **or indications of interest that** are only accessible to a small set of subscribers to a firm's trading platform.
- **Use of ADR Conversions for Close Out of Fails:** Impermissibly extending the SEC guidance regarding Rule 204 and closing out fails using ETF conversions to **other types of** conversions **(*e.g.*, ADR).**

Effective Practices

- **Supervision of Bona Fide Market Making:** Developing supervisory systems for and conducting supervisory reviews of market making activity to ensure that any reliance on Regulation SHO bona fide market making exceptions is appropriate by considering, for example:
  - where the firm's quotes are placed and how (*e.g.,* market participants vs. ATS, visible or non-visible orders);
  - the frequency or timing of the firm's quoting activity (*e.g.*, morning or evening vs. throughout the trading day); and
  - the level of the firm's proprietary trades compared to customer transactions filled.
- **Supervision of Rule 204 Close-Out Activity:** Developing appropriate policies and procedures to ensure that the firm's close-out actions consistently adhere to the purchase or borrow requirements of Rule 204**, as well as any written guidance related to the requirements of Rule 204 (*e.g.,* the 2017 SEC No Action Letter).**

Additional Resources

- SEC
  - **Request for No-Action Relief Under Rule 204 of Regulation SHO (April 26, 2017)**
  - Amendments to Regulation SHO, Exchange Act Rel. No. 34-58775 (October 14, 2008)

Fixed Income—Fair Pricing

Regulatory Obligations

The fair pricing obligations under FINRA Rule 2121 (Fair Prices and Commissions) apply to transactions in all securities—including fixed income securities—and MSRB Rule G-30 (Prices and Commissions) imposes similar obligations for transactions in municipal securities. In addition, FINRA Rule 2121 and MSRB Rule G-30 include specific requirements for transactions in debt securities. These rules generally require a dealer that is acting in a principal capacity in a debt security transaction with a customer, and charging a mark-up or mark-down, to mark up or mark down the transaction from the prevailing market price (PMP). The PMP is presumptively established by referring to the dealer's contemporaneous cost as incurred or proceeds as obtained. Where the dealer's cost is no longer contemporaneous, or the dealer has overcome the contemporaneous cost presumption, firms are required to continue down the "waterfall" within FINRA Rule 2121 or MSRB Rule G-30, as applicable, to determine the PMP.

Findings and Effective Practices

Findings

- **Incorrect Determination of PMP:** Not following the contemporaneous cost presumption or the waterfall required by FINRA Rule 2121 and MSRB Rule G-30, but rather:
  - using other methods, such as obtaining quotations from a limited number of market participants without considering contemporaneous inter-dealer or institutional transaction prices;
  - referring to acquisition costs that are no longer contemporaneous;
  - **relying on third-party software to determine the PMP, but:**
    - **not understanding how the software determines the PMP, notwithstanding the firm's ultimate responsibility for ensuring the PMP is determined in accordance with FINRA Rule 2121 and MSRB Rule G-30;**
    - **not ensuring that the software could access all information necessary to properly determine the PMP (*e.g.,* the feed of firm's own trading was incomplete); or**
  - **permitting registered representatives to determine the PMP through a manual override of the third-party software, while:**
    - **not appropriately supervising how the PMP was determined in manual overrides;**
    - **not maintaining documentation regarding how the PMP was determined in manual overrides; or**
  - **determining the PMP based on the firm's quotation prices, rather than determining the PMP in accordance with the waterfall.**
- **Outdated Mark-Up/Mark-Down Grids:** Employing mark-up/mark-down grids without periodically reviewing and updating them as needed.
- **Failure to Consider Impact of Mark-Up on Yield to Maturity:** Charging substantial mark-ups in short-term, fixed-income securities that may significantly reduce the yield received by the investor.

- **Unreasonable Supervision:** Solely relying on grids or on fixed mark-up/mark-down thresholds in assessing fair pricing in fixed income securities without performing a facts and circumstances analysis as required by FINRA Rule 2121 or MSRB Rule G-30.

Effective Practices

- **PMP Documentation:** Documenting the PMP for each transaction, even if it does not require a mark-up/mark-down disclosure pursuant to FINRA Rule 2232 (Customer Confirmations) or MSRB Rule G-15 (Confirmation, Clearance, Settlement and Other Uniform Practice Requirements with Respect to Transactions with Customers).
- **Mark-Up/Mark-Down Reviews:** Conducting periodic reviews of the firm's mark-ups/mark-downs and comparing them with industry data provided in the TRACE and MSRB Mark-Up/Mark-Down Analysis Reports.
- **Exception Reports:** Using exception reports or outside third-party vendor software to ensure compliance with FINRA Rule 2121 or MSRB G-30; and periodically reviewing and updating the reports' parameters so they perform as intended, even as market conditions change.

Additional Resources

- FINRA
  - *FINRA Data*
    - Fixed Income Data
  - Fixed Income Confirmation Disclosure: Frequently Asked Questions (FAQ) Key Topics Page
  - MSRB Markup/Markdown Analysis Report
  - TRACE Markup/Markdown Analysis Report
  - *Regulatory Notices*
    - *Regulatory Notice 21-29* (FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors)
    - *Regulatory Notice 17-08* (SEC Approves Amendments to Require Mark-Up/Mark-Down Disclosure on Confirmations for Trades With Retail Investors in Corporate and Agency Bonds)
- MSRB
  - Resource on Disclosing Mark-ups and Determining Prevailing Market Price (July 2018)
  - Confirmation Disclosure and Prevailing Market Price Guidance: Frequently Asked Questions (March 19, 2018)

OTC Quotations in Fixed Income Securities

Regulatory Obligations

SEA Rule 15c2-11 governs the publication or submission of quotations by broker-dealers in a quotation medium other than a national securities exchange (*i.e.*, the OTC market).[57] The rule generally prohibits a broker-dealer from publishing a quotation for any security in a quotation medium unless the broker-dealer has reviewed current and publicly available information about the issuer whose security is the subject of the quotation, and the broker-dealer believes this information is accurate and obtained from a reliable source. Municipal securities and other "exempt securities" (*e.g.*, government securities, Treasury securities) are not subject to the rule.

In September 2020, the SEC adopted amendments to the rule and issued a series of no-action letters providing relief for fixed income securities with defined criteria, set to expire on January 4, 2025. **On October 30, 2023, the SEC issued an order providing permanent exemptive relief for fixed income securities sold in compliance**

with the safe harbor in SEA Rule 144A, and on November 22, 2024, the SEC issued a new no-action letter, without an expiration date, to extend the relief previously provided for other fixed income securities.

FINRA Rule 3110 (Supervision) requires that firms establish and maintain a system to supervise, including written procedures, reasonably designed to achieve compliance with the requirements of the Rule.

Findings and Effective Practices

Findings

- **Inadequate Supervisory Controls and Procedures:**
  - Not maintaining controls and procedures reasonably designed to monitor quoting activity in fixed income securities **on all quotation mediums the firm uses**; and not reviewing the firm's activity to determine applicability of SEA Rule 15c2-11.
  - **Improperly excluding from the firm's systems and controls and written procedures publications of "quotations" on "quotation mediums," including platforms that** are not ATSs **and other systems that meet SEA Rule 15c2-11's definition of "quotation medium."**
  - **Not including in the firm's systems and controls and written procedures publications of "quotations" on a "quotation medium" to all counterparties, including both broker-dealer and non-broker-dealer customers**.
- **Failing to Test Applicability:** Stating that the firm only quotes in exempt securities without conducting an analysis **or documenting the basis for such determinations.**
- **Failing to Prevent Potential Quotations:** Not implementing procedures and controls—including a process for complying with SEA Rule 15c2-11—to ensure that the firm does not quote a covered security prior to confirming the availability of public financial information (unless an exception under the Rule is available).

Effective Practices

- **Testing Applicability: Periodically reassessing the applicability of SEA Rule 15c2-11 to the firm's business activities.**
- **Supervisory Controls and Procedures:** Maintaining reasonable controls and procedures designed to fit the firm's specific business, including training firm personnel who are impacted.
- **Front-End Surveillance:** Identifying non-exempt securities and quotation mediums; blocking non-exempt securities from quotation on specific trading platforms determined to be quotation mediums; and warning users when accessing non-exempt securities.
- **Self-Assessment:** Conducting an analysis of the firm's business and systems in quoting fixed income securities.
- **Third-Party Vendors:** Contracting with third-party vendors to help:
  - confirm the availability of current information regarding the issuer of the fixed income security—or the availability of an exemption—prior to quoting; and
  - identify and prevent quoting in non-exempt securities where such information (or exemption) is not available.

Additional Resources

- FINRA
  - *Regulatory Notice 21-29* (FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors)

- SEC
  - **No Action Letter to FINRA re: Amended Rule 15c2-11 in Relation to Fixed Income Securities (November 22, 2024)**
  - **Order Granting Broker-Dealers Exemptive Relief, Pursuant to Section 36(a) and Rule 15c2-11(g) under the Securities Exchange Act of 1934, from Rule 15c2-11 for Fixed-Income Securities Sold in Compliance with the Safe Harbor of Rule 144A under the Securities Act of 1933 (October 30, 2023)**

Market Access Rule

Regulatory Obligations

SEA Rule 15c3-5 (Market Access Rule) requires firms with market access or that provide market access to their customers or any other person 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, ETFs, debt securities, security-based swaps and security futures products.

Findings and Effective Practices

Findings

- **Insufficient Controls:**
  - Not establishing pre-trade order limits, preset capital thresholds and duplicative and erroneous order controls for accessing ATSs, including those that transact fixed income transactions.
  - Setting pre-trade order limits at unreasonable thresholds based on a firm's business model.
  - Not demonstrating and failing to maintain documentation demonstrating the reasonability of assigned capital, credit and erroneous order pre-trade financial controls.
  - Not establishing adequate 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, or documenting justifications for any adjustments and ensuring thresholds for temporary adjustments to revert back to their pre-adjusted values.
  - **Overly relying on multiple, stand-alone risk management control systems, and failing to consider market access controls in the aggregate (*e.g.*, failing to assess excessive messaging across different ports and venues for a given customer).**
- **Failure to Consider Additional Data:** Failing to consider a firm's business model when setting pre-trade order limits or other regulatory requirements (*e.g.*, Limit Up-Limit Down (LULD) thresholds, exchanges' Limit Order Price Protection thresholds), as well as historical and available liquidity and the time required for liquidity replenishment when determining erroneous price and size control thresholds.
- **Impermissible Exclusions:** Excluding certain orders from a firm's pre-trade erroneous controls based on order types (*e.g.*, excluding limit on close orders from a firm's price controls).
- **Inadequate Financial Risk Management Controls**: For firms with market access, or those that provide it, having unreasonable capital thresholds for trading desks and unreasonable aggregate daily limits or credit limits for institutional customers and counterparties.
- **Reliance on Third-Party 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 third-party 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.

- **Inadequate Post Trade Surveillance:** Failure to conduct post trade reviews for potential manipulation.
- **Failure to Document Annual Review of Effectiveness:** Failure to document the firm's review, conducted at least annually, of the effectiveness of its risk management controls and supervisory procedures (*e.g.*, no inventory of the specific systems, controls, thresholds or functionality that were reviewed), including the reasonableness of the firm's market access controls applicable to each business/product line in which the firm provides market access.

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.
- **Soft Blocks:**
  - Implementing detailed and reasonable WSPs that list the steps that firm personnel should take when determining how to handle orders that trigger soft controls; and requiring staff to document their findings and rationale for releasing an order following a review.
  - Conducting a separate supervisory review to ensure that release rationales are appropriate; and requiring the incorporation of review results when assessing the effectiveness of the firm's controls.
- **Tailored Controls to Prevent Erroneous or Duplicative Orders**:
  - Tailoring controls to prevent erroneous or duplicative orders to particular products, situations **(*e.g.*, corporate actions),** or order types; and preventing the routing of market orders based on impact (*e.g.,* 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.
  - Ensuring that controls apply to all order flow and all trading sessions.
- **Market Impact:** Developing reasonable complementary controls (*e.g.*, a market impact check, a liquidity check, an average daily volume control) based upon the firm's business model and historical order flow; and using a benchmark when pricing child orders for a larger parent market order (*e.g.*, the National Best Bid and Offer (NBBO) or last sale at the time of the initial child order route) to monitor the cumulative market impact of subsequent child orders over a short period of time.
- **Reference Data:** Using a reasonable process for choosing reference data in developing various controls, so if one piece of data is not obtained another could be substituted (*e.g.*, the NBBO versus the last sale or the previous day's closing price).
- **Post-Trade Controls and Surveillance**: When providing direct market access via multiple systems, including sponsored access arrangements, employing reasonable controls to confirm that the 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 Risk Management Controls:** Regularly testing market access controls, such as:
  - performing a review, at least annually, of the business activity of the firm in connection with market access;
  - maintaining data and documents that evidence the rationale for continued use of implemented controls and parameters;
  - focusing on the parameters for controls and analyzing whether they are reasonable and would prevent the entry of erroneous orders under different scenarios (*e.g.*, the entry of a large order in a thinly-traded or high-priced security) and product types;
  - determining whether hard blocks are working (*e.g.*, triggered when a parameter is triggered);

- determining whether soft blocks are an effective control (*e.g.*, by outlining specific steps for, and appropriately documenting, those reviews);
- documenting reviews and retaining information used in decisions to adjust, maintain or create new controls (*e.g.*, change in business lines may result in short period-of-time controls in addition to order-by-order controls);
- **reviewing any automated controls to timely revert *ad hoc* credit limit adjustments; and**
- **for firms that provide clients sponsored access, verifying ability to retain direct and exclusive control over the pre-trade financial and regulatory requirements.**

- **Training: Conducting training for individual traders regarding the steps and requirements for requesting *ad hoc* credit limit adjustments.**

Additional Resources

- FINRA
  - Algorithmic Trading Key Topics Page
  - Market Access Key Topics Page
  - *Regulatory Notices*
    - *Regulatory Notice* *16-21* (Qualification and Registration of Associated Persons Relating to Algorithmic Trading)
    - *Regulatory Notice* *15-09* (Guidance on Effective Supervision and Control Practices for Firms Engaging in Algorithmic Trading Strategies)
    - *Notice to Members* *04-66* (NASD Reminds Member Firms of Their Obligations to Ensure the Accuracy and Integrity of Information Entered into Order-Routing and Execution Systems)
- SEC
  - Responses to Frequently Asked Questions Concerning Risk Management Controls for Brokers or Dealers with Market Access (April 15, 2014)

Extended Hours Trading NEW FOR 2025

Regulatory Obligations

Over the last few years, trading in NMS stocks and other securities has increasingly stretched beyond regular trading hours (*i.e.*, 9:30 a.m. to 4:00 p.m. ET). As a result, FINRA has observed a growing number of firms offering varying degrees of extended hours trading services, in some cases including the overnight period of 8 p.m. to 4 a.m. ET.

FINRA Rule 2265 (Extended Hours Trading Risk Disclosure) requires that firms that permit customers to engage in extended hours trading provide customers with a risk disclosure statement. In addition, if the firm permits customers to engage in extended hours trading online, or open accounts online in which the customer may engage in extended hours trading, the firm must post a risk disclosure statement on the firm's website in a clear and conspicuous manner. The risk disclosure must address, at a minimum, the six specific risks identified in Rule 2265, and firms must also consider whether to develop and include additional disclosures as necessary to address product-specific or other specific needs.

Firms that participate in extended hours trading must also comply with other FINRA and SEC rules applicable to such trading, including without limitation FINRA Rule 5310 (Best Execution and Interpositioning), and must ensure they meet their supervisory obligations for extended hours activity under FINRA Rule 3110 (Supervision).

Findings and Effective Practices

Findings

- **Inadequate Supervision:** Failing to maintain reasonably designed supervisory systems and controls, including with respect to the identification and reporting of potentially manipulative activity conducted in after-hours trading.[58]
- **Reporting Failures:** Failing to report to FINRA's Trade Reporting Facilities (TRF) or CAT required information arising from activity conducted during extended hours trading.

Effective Practices

- **Best Execution Reviews:** Evaluating how extended hours orders are handled, routed and executed in regular and rigorous best execution reviews to confirm that the firm's practices are reasonably designed to achieve best execution.
- **Customer Disclosures:** Reviewing customer disclosures about the risks of extended hours trading to ensure that such disclosures address, at a minimum, the risks enumerated in FINRA Rule 2265; evaluating whether any additional product-specific or other disclosures may be necessary to address other risks related to extended hours trading; and reviewing any customer disclosures about the firm's customer order handling procedures.
- **Supervisory Processes:** Establishing and maintaining reasonably designed supervisory processes that address any unique characteristics or risks of extended hours trading, such as customer order handling and volatile or illiquid market conditions.
- **Operational Readiness, Customer Support and Business Continuity Planning:** Evaluating unique operational readiness and customer support needs during overnight hours, as well as the availability of backup trading arrangements during trading sessions that are offered to customers and considering appropriate communications with customers about potential service interruptions.

Additional Resources

- FINRA Rule 2265 (Extended Hours Trading Risk Disclosure)
- Investor Insights—Extended-Hours Trading: Know the Risks (July 31, 2024)
- *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)

Upcoming Trade Reporting Enhancements for Fractional Share Transactions

- FINRA's trade reporting rules generally require firms to transmit last sale reports of transactions in NMS stocks to a FINRA trade reporting facility (TRF) or the Alternative Display Facility (ADF) and OTC equity securities to FINRA's over-the-counter trade reporting facility (ORF). Firms must transmit these reports as soon as practicable, but no later than 10 seconds after execution.[59]
- Under the applicable trade reporting rules, each last sale report must include the number of shares in the transaction.
  - However, while firms may execute transactions in fractional share amounts, the FINRA facilities do not currently support the entry of fractional share quantities.
  - Therefore, trades in fractional share quantities of less than one share must be reported by rounding up to one share in the "Quantity" field. When reporting a trade for a fractional number of shares greater than one, the firm must instead truncate the quantity and report the whole number portion.[60]
- FINRA is planning to implement enhancements to the FINRA facilities to support the reporting of fractional share quantities.
  - Upon implementation of the enhancements,[61] FINRA will add a new "Fractional Share Quantity" field in addition to the existing "Quantity" field. Firms will continue to populate the "Quantity" field as they do today using whole numbers (with fractional amounts either rounded up or truncated, as described above).
  - However, for a transaction with a fractional component, firms will also be required to populate the new "Fractional Share Quantity" field by entering the entire quantity of the trade, including the fractional component up to six digits after the decimal. The "Fractional Share Quantity" field must remain blank for trades with whole number quantities (no fractional component).
  - Firms that do not engage in fractional trading will not have to make any reporting changes.
- For additional guidance concerning these upcoming enhancements, please see *Trade Reporting Notice 3/22/24* (Advance Notice: Upcoming Trade Reporting Enhancements for Fractional Share Transactions).

Financial Management

Net Capital

Regulatory Obligations

SEA 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. SEA Rule 17a-11 requires firms to notify FINRA and the SEC in the event their net capital falls below the minimum amount required by the Net Capital Rule.

If firms have an affiliate or parent paying any of their expenses, FINRA *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. Additionally, firms must align their revenue recognition practices with the requirements of the Financial Accounting Standards Board's (FASB) Topic 606 (Revenue from Contracts with Customers), which is a **foundation for compliance with the Net Capital Rule, SEA Rule 17a-3 and 17a-5**. **As noted in *Regulatory Notice* 23-21 (FINRA Reminds Member Firms of Net Capital, Recordkeeping and Financial Reporting Requirements in Connection with Revenue Recognition Practices) firms are advised to ensure that they are able to demonstrate their proper application of Accounting Standards Codification (ASC) 606.**

Findings and Effective Practices

Findings

- **Inadequate Supervision: Not having a reasonable process to determine when the firm has a net capital deficiency and should begin the process of suspending business operations, and ensure the firm files timely notices of its net capital deficiencies.**
- **Incorrect Capital Charges for Underwriting Commitments:** Not maintaining an adequate process to assess moment-to-moment net capital and open contractual commitments **(OCC)** capital charges on underwriting commitments; not establishing and maintaining WSPs for calculating and applying **OCC** charges; not maintaining an accurate record or log of underwritings in which the firm is involved; and not understanding the firm's role in the underwriting (*i.e.*, best efforts or firm commitment).
- **Inaccurate Net Capital Deductions:** Not maintaining a process or **WSPs** to accurately **compute capital charges** of nonmarketable securities (*e.g.,* **failing to compute** marketplace blockage **properly);** and for certain firms, applying "minimal amount of credit risk standard" despite not having an adequate process to conduct an internal credit analysis or an independent creditworthiness analysis of corporate and nonconvertible debt securities.
- **Inaccurate Recording of Revenue and Expenses:** Not recording transactions in a timely manner, resulting in the firm's noncompliance with SEA Rule 17a-3; or noncompliance generally with US Generally Accepted Accounting Principles (GAAP) by not maintaining financial records on an accrual basis.
- **Late or Inadequate Filings: Failing to timely file required notices of net capital deficiencies with FINRA and the SEC, and filing other notices that inaccurately reflected the firm's aggregate indebtedness, minimum required net capital or excess net capital.**
- **Insufficient Capital for Underwriting Participation: Acting in the capacity as the lead underwriter without maintaining sufficient net capital to participate in the underwriting and cover the required OCC charges.**
- **Inaccurate OCC Charges: Failing to accurately capture OCC charges on firm commitment offerings (*e.g.*, only capturing charges for the day of the pricing date or the settlement date, not capturing charges on unsold portion of underwriting from pricing date through settlement date, applying an incorrect haircut percentage on charges).**

Effective Practices

- **Net Capital Assessment:** Performing an **ongoing** assessment of the net capital treatment of assets to confirm that they were correctly classified for net capital purposes.
- **Moment-to-Moment and Net Capital Compliance for Underwriting Commitments:** Establishing **control processes** and maintaining current WSPs for:
  - ensuring the firm's role is clear within the agreement as it relates to its role in the underwriting (*i.e.*, best efforts **(either in a contingent or a firm commitment offering)** or as having a firm commitment);
  - establishing a process to track open contractual commitments in which the firm is involved **at all times;** and
  - calculating and applying **OCC** charges, as well as focusing on the product and proper haircut percentage.

Additional Resources

- FINRA
  - Interpretations to the SEC's Financial and Operational Rules
  - *Regulatory Notices*
    - *Regulatory Notice 23-21* (FINRA Reminds Member Firms of Net Capital, Recordkeeping and Financial Reporting Requirements in Connection with Revenue Recognition Practices)
    - *Notice to Members 03-63* (SEC Issues Guidance on the Recording of Expenses and Liabilities by Broker/Dealers)
- SEC
  - **SEC Modernizes the Submission of Certain Forms, Filings, and Materials Under the Securities Exchange Act of 1934 (December 16, 2024)**
  - Frequently Asked Questions Concerning the Amendments to Certain Broker-Dealer Financial Responsibility Rules
- FASB
  - ASU 2014-09 Revenue From Contracts With Customers (Topic 606)

Liquidity Risk Management

Regulatory Obligations

Effective monitoring of liquidity and funding risks is an element of broker-dealers' financial responsibility and is a longstanding focus for FINRA's Risk Monitoring and Examination programs. 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), *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) **and *Regulatory Notice 10-57* (Funding and Liquidity Risk Management Practices).**

FINRA's Supplemental Liquidity Schedule (SLS) was effective on March 1, 2022.[62] The SLS is a supplemental filing to the FOCUS Reports **and generally is required** of firms with the largest customer and counterparty exposures. The SLS is designed to improve FINRA's ability to monitor for events that signal an adverse change in these firms' liquidity risk.

Observations and Effective Practices

Observations

- **Insufficient Stresses on Clearing Deposit Requirements:** Incorrectly basing stresses on clearing deposit requirements on information that doesn't necessarily represent the firm's business operations (*e.g.,* **only** using the amounts reflected on **month-end** FOCUS reports rather than **reviewing for material** fluctuations in deposit requirements that may have occurred intra-month) **and insufficiently accounting for substantial regulatory or product changes (*e.g.*, centralized clearing of Treasuries, the move to the T+1 settlement cycle).**
- **Unreasonable Stress Test Assumptions: Incorporating unreasonable assumptions into stress tests that materially misrepresent the firm's liquidity position (*e.g.*, inaccurately determining the amount of a firm's inventory that would require financing in a stressed environment; relying on funding sources in a stress event that a firm does not engage with in a business-as-usual (BAU) environment).**

- **Inadequate Supervision: Firm departments responsible for liquidity risk oversight (*e.g.,* second and third lines of defense) not identifying unreasonable assumptions or inaccurate calculations that existed in liquidity stress tests.**
- **Inadequate or No Contingency Funding Plans:** Failing to develop contingency funding plans that would provide sources of liquidity for operating under market or idiosyncratic 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 funding would be used.
- **Inaccurate SLS Reporting:** Providing inaccurate or incomplete information in the firm's SLS, **including:**
  - incorrectly **reporting** agent lenders **rather than underlying principals** as counterparties to repurchase agreements, reverse repurchase agreements and securities borrowed transactions;
  - providing incomplete information regarding noncash securities lending transactions (*i.e.,* identifying either the received collateral or delivered collateral, but not both); and
  - not completing the line item for "Total Available Collateral in Broker-Dealer's Custody" (or entering inaccurate information).

Effective Practices

- **Liquidity Risk Management Updates:** Updating liquidity risk management practices, policies and procedures to conform with the firm's current business activities, including:
  - establishing governance around liquidity risk management, including determining who is responsible for monitoring the firm's liquidity position, the frequency of monitoring, and the communication and coordination protocols; and
  - creating a liquidity management plan that considers:
    - liquidity use assumptions that are based on both idiosyncratic and market-wide conditions and stress scenarios;
    - sources of funding in both business-as-usual and stressed conditions;
    - stability and other characteristics of funding sources ***(e.g.***, **restrictive covenants or material adverse change clauses within funding contracts that could affect the availability of the funding under certain conditions);**
    - the type and quantity of available collateral needed to secure funding;
    - potential mismatches in duration between liquidity sources and uses;
    - a contingency plan in the event of loss of funding sources; and
    - early warning indicators of liquidity loss and escalation procedures.
- **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;
  - changes to the stability and quality of liquidity sources relied upon for its funding needs in a stressed environment;
  - **material swings in customer cash balances (*e.g.*, redemptions, interest payments, sweeps);**
  - the potential impact of off-balance sheet items (*e.g.,* nonregular way settlement trades, forward contracts **and related margin requirements)** on the firm's liquidity needs; and
  - periodic governance group review of stress test parameters **based on current data.**

- **Contingency Funding: Considering any restrictive covenants and material adverse change clauses in contracts that could impact the availability of contingency funding.**

Additional Resources

- FINRA
  - Funding and Liquidity Key Topics Page
  - Frequently Asked Questions: Supplemental Liquidity Schedule

Segregation of Assets and Customer Protection

Regulatory Obligations

SEA 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 customers' fully paid and excess margin securities and safeguard customer funds. Firms satisfy these requirements by keeping customer funds in a special reserve bank account and by maintaining customer securities in their physical possession or in a good control location, as specified in Rule 15c3-3. Firms are required to maintain a reserve of cash or qualified securities in the special reserve bank account that is at least equal in value to the net cash owed to customers, including cash obtained from the use of customer securities. The amount of net cash owed to customers is computed pursuant to the formula set forth in Exhibit A to Rule 15c3-3.

SEC Adopts Rule Amendments to the Broker-Dealer Customer Protection Rule

- The SEC adopted amendments to Rule 15c3-3 to require certain firms to increase the frequency with which they perform computations of the net cash they owe to customers and other broker-dealers from weekly to daily.
- The SEC also adopted amendments to Rule 15c3-3 and Rule 15c3-1 to permit certain broker-dealers that perform a daily customer reserve computation to decrease the required 3 percent "buffer" in the customer reserve bank account by reducing the customer-related receivables, or "aggregate debit items," charge from 3 percent to 2 percent in the computation.
- For additional information, please see the SEC's Daily Computation of Customer and Broker-Dealer Reserve Requirements under the Broker-Dealer Customer Protection Rule.

Findings and Effective Practices

Findings

- **Inadequate Supervision: Failing to establish and maintain a reasonably designed supervisory system for reserves, resulting in issues including:**
  - **incorrectly designating customer accounts as noncustomer accounts for purposes of the reserve formula computation;**
  - **failing to identify, track or age suspense items; and**
  - **failing to ensure bank sweep programs are compliant.**
- **Inaccurate Reserve Formula Computations:** Failing to complete accurate reserve formula computations due to factors **including:**
  - inadequate supervisory procedures and processes;
  - limited coordination between various internal departments;
  - inaccurate account coding;

- **inadequate understanding of the relevant requirements under the Customer Protection Rule; and**
- **not detecting or resolving coding errors in firm systems that resulted in inaccurate credit and debit balances being included in the computation.**

- **Insufficient Segregation of Customer Securities:** Failing to maintain possession or control of customer fully paid or excess margin securities due to inadequate supervisory procedures and processes to identify, monitor and resolve possession or control deficits, and inaccurate coding of good control locations.
- **Inadequate Handling of Customer Checks: Firms accepting customer checks as part of their business practice, but failing to establish an adequate process to promptly forward them (*e.g.*, not maintaining a *checks received and forwarded* blotter, not having a procedure for handling customer checks written payable to the firm).**

Effective Practices

- **Periodic Evaluation of the Reserve Formula Computation Process:** Performing variance analysis to review for material fluctuations, **anomalies** and new items to identify potential inaccuracies; establishing a process to identify system or operational changes that could impact the customer or PAB reserve formula computations; **and reviewing adjustments to the reserve formula computations to ensure they are accurate and compliant with the Customer Protection Rule.**
- **Good Control Locations:** Ensure that all relevant documents are maintained to support the treatment of accounts as good control locations and perform periodic reviews to identify **newly established accounts**, potential miscoding, out-of-date paperwork or inactivity.
- **Check Forwarding Blotter Review:** Creating and reviewing your firm's checks received and forwarded blotters to confirm that they are accurately maintained and include the information required to evidence compliance with the Customer Protection Rule exemption.
- **Supervision:** Ensuring experienced individuals perform and supervise reserve formula computations and possession or control processes (who also hold the proper registrations).

Additional Resources

- FINRA
  - Interpretations to the SEC's Financial and Operational Rules
- SEC
  - **Daily Computation of Customer and Broker-Dealer Reserve Requirements under the Broker-Dealer Customer Protection Rule (December 20, 2024)**

FINRA Reminds Firms of Their Obligations to Designate FINOPs

- FINRA reminds firms of the requirement to designate a qualified Financial and Operations Principal (FINOP) and such FINOP's responsibilities under FINRA Rule 1220(a)(4) (Registration Categories).
- Among other things, FINRA Rule 1220(a)(4) requires each firm subject to SEA Rule 15c3-1 to designate either an appropriately registered Financial and Operations Principal (Series 27) or an Introducing Broker-Dealer Financial and Operations Principal (Series 28) and to also designate a Principal Financial Officer (PFO) and Principal Operations Officer (POO), who must be qualified as a FINOP. The rule specifies the duties for which the FINOP is responsible and the responsibilities of the PFO and POO.
- In addition to responsibility for the final approval and the accuracy of financial reports, a FINOP's duties and responsibilities under Rule 1220 include, among other things, supervision of and responsibility for individuals who are involved in the creation and maintenance of the firm's books and records from which such reports are derived and overall supervision of and responsibility for the individuals who are involved in the administration and maintenance of the firm's back office operations.
  - The responsibilities noted above and in Rule 1220(a)(4) are applicable regardless of whether a FINOP is employed full-time or part-time with a firm, holds registrations with multiple firms, or performs his or her duties on-site or off-site of the firm.
- *Notice to Members* *06-23* (NASD Reminds FINOPs of their Obligations under NASD Rule 1022 and Issues Guidance to FINOPS who Work Part-Time, Work Off-Site or Hold Multiple Registrations) was published to remind FINOPs and firms of their obligations when a FINOP is employed part-time.
  - Part-time FINOPs and firms that employ them should review their procedures to ensure that they encompass the duties outlined in Rule 1220 and thoroughly outline the part-time FINOP's responsibilities.
  - Further, firms must ensure that the part-time FINOP has complete access to all of the firm's books and records and all relevant information about the firm's business activities necessary to enable the FINOP to carry out his or her duties and responsibilities. Firms are required to supervise their part-time FINOPs and assess whether they are fulfilling their duties and responsibilities.
- FINRA reminds firms and their FINOPs that the failure to meet their responsibilities under the rules can result in disciplinary actions against both the FINOP and the firm employing the FINOP. While firms must also designate a PFO and POO, these designations do not relieve a firm's FINOP from their obligations to fulfill their duties under 1220(a)(4).[63]
- During recent examinations, FINRA observed recurring themes concerning certain firms' use of part-time FINOPs (*e.g.*, not having access to books and records; not adequately performing reconciliations).
- For additional guidance in this area, please see:
  - *Regulatory Notice* *17-30* (SEC Approves Consolidated FINRA Registration Rules, Restructured Representative-Level Qualification Examinations and Changes to Continuing Education Requirements)
  - *Notice to Members* *06-23* (NASD Reminds FINOPs of their Obligations under NASD Rule 1022 and Issues Guidance to FINOPS who Work Part-Time, Work Off-Site or Hold Multiple Registrations)

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

Firms have shared the following ways they have used prior FINRA publications, such as Exam Findings Reports, Priorities Letters and Reports on FINRA's Examination and Risk Monitoring Program, to enhance their compliance programs. Firms may consider these practices, if relevant to their business model. We welcome feedback on how our firms use FINRA publications.

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

Endnotes

1 **Generative artificial intelligence is a type of artificial intelligence that, based on a user's prompt, can create content such as text, computer code, audio and video.**

2 Capital Acquisition Broker (CAB) Rule 331 (Anti-Money Laundering Compliance Program) applies AML compliance program requirements to Capital Acquisitions Brokers.

3 31 CFR § 1023.320 requires broker-dealers to file reports of suspicious transactions (SARs) relevant to a possible violation of law or regulation—such as money laundering, fraud, or sanctions violations—to the extent and in the manner required by that regulation.

4 *See* 31 C.F.R. Part 1010 and 31 C.F.R. Part 1023.

5 ***See* the Senior Investors and Trusted Contact Persons topic for additional guidance.**

6 ***Id.***

7 *See* FinCEN, Section 314(a) for additional guidance.

8 ***See* FinCEN SAR Filings By Industry.**

9 **For additional guidance related to identifying, mitigating and preventing account takeovers and new account fraud (*e.g.*, methods for verifying customer identities upon account opening and on an ongoing basis thereafter), *see* the Cybersecurity and Cyber-Enabled Fraud, and Anti-Money Laundering, Fraud and Sanctions, topics in the 2025 Report, as well as the Anti-Money Laundering, Fraud and Sanctions topic in the 2024 Report.**

10 An identity verification method where applicants upload a photo or video of themselves, which is then compared with their recently submitted identity documents (*See Regulatory Notice 21-18* (FINRA Shares Practices Firms Use to Protect Customers from Online Account Takeover Attempts)).

11 **The term "deepfake" refers to a type of highly realistic multimedia—including text, images, sound and videos—made using machine learning, a subset of AI.**

12 *See* the 2023 Report's Anti-Money Laundering, Fraud and Sanctions topic.

13 *See Regulatory Notice 22-25* (Heightened Threat of Fraud).

14 **See the Report's Anti-Money Laundering, Fraud and Sanctions topic's Investment Fraud by Bad Actors Targeting Investors Directly "callout" box for additional examples of fraudulent schemes that target investors.**

15 ***See Regulatory Notice 21-29* (FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors) for additional guidance concerning third-party vendors (*e.g.*, common activities or functions firms outsource to third-party vendors; questions firms may consider when evaluating their systems, procedures and controls relating to third-party vendor management).**

16 **The FINRA Cybersecurity Advisory—Increasing Cybersecurity Risks at Third-Party Providers incorporates the National Institute of Standards and Technology's (NIST) definition of third-party providers: "service providers, integrators, vendors, telecommunications, and infrastructure support that are external to the organization." However, its guidance is still applicable to firms that are designing or strengthening their compliance programs with regard to third-party vendor risk management.**

17 **As noted in *Regulatory Notice 21-29* (FINRA Reminds Firms of their Supervisory Obligations Related to Outsourcing to Third-Party Vendors), "covered activities" refers to "activities or functions that, if performed directly by a member firm, would be required to be the subject of a supervisory system and WSPs pursuant to FINRA Rule 3110."**

18 **The Regulation S-P amendments will require covered institutions, as part of their incident response programs, to establish, maintain and enforce written policies and procedures reasonably designed to require oversight, including through due diligence and monitoring, of service providers. These policies and procedures must be reasonably designed to ensure that service providers take appropriate measures to (i) protect against unauthorized access to or use of customer information; and (ii) provide notification to the covered institution as soon as possible, but no later than 72 hours after becoming aware that a breach in security has occurred resulting in unauthorized access to a customer information system maintained by the service provider.**

19 ***See* the Report's Emerging Risk: Adversarial Use of Generative Artificial Intelligence "callout" box for more guidance concerning firms' use of Gen AI technology.**

20 ***See* the Report's Third-Party Risk Landscape topic for additional information on FINRA's vendor questionnaire to firms, as well as guidance concerning firms' use of third-party vendors.**

21 **As noted in *Regulatory Notice 24-09* (FINRA Reminds Members of Regulatory Obligations When Using Generative Artificial Intelligence and Large Language Models), to the extent firms find ambiguity in the application of FINRA rules based on their specific use of Gen AI or other technology, they may seek interpretive guidance from FINRA by following FINRA's process for interpretive requests. Firms also are encouraged to have ongoing discussions with their Risk Monitoring Analyst as AI-related issues or other changes in their business arise.**

22 *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.

23 **In the context of the Report, "Off-Channel Communications" are defined as business-related communications sent or received on a communication tool that has not been authorized for business use. The term "Off-Channel Communications" can include, but is not limited to, electronic messaging services such as instant messaging applications, text messages, personal email, direct messaging applications, chat services, and messaging features through third-party vendor applications or social media platforms that are not routinely captured, supervised or retained by an associated person's member firm systems.**

24 Generally, a firm that is already approved by FINRA to engage in private placements or underwriting would not need to file a CMA if they plan to engage in Regulation Crowdfunding activity. For more information, please refer to *Regulatory Notice 16-07* (FINRA Rule 4518 (Notification to FINRA in Connection with the JOBS Act).

25 ***See* the Report's Communications With the Public topic for additional guidance related to spot crypto asset ETP communications.**

26 *See* the Report's Private Placements topic for additional guidance related to conducting reasonable due diligence on unregistered offerings.

27 ***See* 15 U.S.C. 78 lll (14). *See also* SIPC Investor FAQs, Questions About SIPC. FINRA reminds firms that a violation of any rule of the Securities Investor Protection Corporation (SIPC) applicable to firm communications will be deemed a violation of Rule 2210. *See* FINRA Rule 2210(g) and Article 10 of the Bylaws of the Securities Investor Protection Corporation.**

28 ***See* the Report's Artificial Intelligence: Continuing and Emerging Trends "callout" box for additional guidance related to fulfilling regulatory obligations when using Gen AI tools.**

29 **For additional context, see FINRA *Regulatory Notice 23-08* (FINRA Reminds Members of Their Obligations When Selling Private Placements) noting particular concern where the firm or its associated persons are affiliated with the issuer or when red flags are present.** *See also* the Report's Private Placements topic for additional findings related to firms and their associated persons recommending private offerings without having a reasonable basis.

30 **Due to leveraged and inverse exchange-traded products' daily reset function, losses in these products can be compounded if they are held longer than a single trading session**.

31 *See* the Report's Annuities Securities Products topic for additional findings related to firms not reasonably supervising variable annuities recommendations for compliance with Reg BI.

32 *See* the Report's Reg BI and Form CRS topic for additional findings concerning failure to comply with Reg BI's Conflicts of Interest Obligation.

33 **The fourth quarter of 2023 marked the first time RILA sales surpassed variable annuity sales. *See* LIMRA, "LIMRA: Record-High 2023 Annuity Sales Driven by Extraordinary Growth in Independent Distribution," news release (Mar. 12, 2024); *see also* LIMRA, "LIMRA Secure Retirement Institute: Total Annuity Sales Continued to Decline in 2017," news release (Feb. 21, 2018).**

34 **Under a RILA, an insurance company will credit positive or negative "interest" to an investor's contract value at the end of each crediting period. The amount credited is based, in part, on the performance of a specified index or benchmark (*e.g.*, the S&P 500). Crediting periods for an index-linked option in a RILA contract generally range from one to six years. RILA contracts typically state than an investor will be automatically renewed at the end of a crediting period into the same or substantially similar index-linked options, often with a new limit on gains. *See* Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities, Proposed Rule, Securities Act Release No. 11250 (Sept. 29, 2023), 88 FR 71088 (Oct. 13, 2023) ("RILA Registration Proposed Rule Release") at 71090-1; *see also* Registration for Index-Linked Annuities and Registered Market Value Adjustment Annuities, Final Rule, Securities Act Release No. 11294 (July 1, 2024), 89 FR 59978, 59981 (July 24, 2024) ("RILA Registration Final Rule Release"), 89 FR at 59981.**

35 ***See* SEC Office of the Investor Advocate, "Investor Testing Report on Registered Index-Linked Annuities" (September 2023), at page 7.**

36 **Similarly, the performance of an index-linked option may be based on an index that deducts fees and costs when calculating its performance, therefore lowering the index return.**

37 ***See* RILA Registration Final Rule Release, 89 FR at 59981.**

38 **The insurance company typically will apply an "interim value adjustment" (IVA) to the contract value if the investor partially or fully withdraws amounts from an index-linked option before the end of its term. If amounts are withdrawn from the contract, the company also might apply a market value adjustment or MVA to the amount withdrawn. Contract adjustments could be made in response to a number of contract transactions, such as a surrender, withdrawal, payment of a death benefit, or the start of annuity payments, and an investor could experience a negative contract adjustment even when the investor takes an otherwise permissible withdrawal, such as under a guaranteed living benefit.**

39 **A "cap rate" places an upper limit an investor's ability to participate in the index's upside performance. For example, if a RILA has a 5 percent cap rate, and the index increases by 10 percent, at the end of the crediting period the investor's contract value will be credited with only 5 percent positive interest. *Id.***

40 **A "participation rate" sets an investor's return to some specified percentage of the index's return. For example, an 80 percent participation rate would result in an investor receiving positive interest of 80 cents on the dollar of gains in the index. *Id.***

41 **A "buffer" limits the investor's exposure to losses up to a fixed percentage. For example, with a buffer of minus 5 percent, if the index is down 2 percent, the investor will not lose anything, but if the index is down 7 percent, the investor will lose 2 percent (the difference between the loss and the buffer rate). *Id.***

42 **A "floor" places a lower limit on the investor's exposure to loss. For example, with a floor of minus 5 percent, if the index is down 2 percent, the investor will lose 2 percent, but if the index is down 7 percent, the investor will lose only 5 percent. *Id.***

43 **Section 1035 of the Internal Revenue Code allows for a tax-free transfer of an existing annuity contract, life insurance policy, long-term care product or endowment for another of like kind.**

44 *See Regulatory Notice* *20-31* (FINRA Reminds Firms of Their Supervisory Responsibilities Relating to CAT).

45 **EMMA stands for Electronic Municipal Market Access and is the official source for municipal securities data and documents.**

46 **For offerings that are made depository-eligible via DTCC's New Issue Information Dissemination Service (NIIDS), certain information entered into NIIDS flows directly into Form G-32 and will be pre-populated.**

47 MSRB Rule G-18 (Best Execution) sets forth similar obligations with respect to transactions in municipal securities.

48 In this situation, the routing firm and receiving firm may have different best execution obligations. *See* Supplementary Material .09 to FINRA Rule 5310 (Best Execution and Interpositioning).

49 **FINRA will separately issue a *Regulatory Notice* regarding Rule 6470 (Disclosure of Order Routing Information for OTC Equity Securities), which will require firms to create and submit to FINRA order routing disclosures for OTC Equity Securities. FINRA intends to provide firms with sufficient implementation time to comply with Rule 6470 and will publish technical information and guidance, as appropriate, at least eight months in advance of the effective date, which will be announced at a future time. *See Regulatory Notice 24-05.***

50 *See* SEC Division of Market Regulation, Staff Legal Bulletin No. 13A, Frequently Asked Questions About Rule 11Ac1-6, FAQ #9.

51 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.

52 **Under the SEC's rules, such an agency is a "covered clearing agency," meaning a registered clearing agency that provides the services of a central counterparty or central securities depository.**

53 **The term "direct participants" refers to "the entities that directly access a U.S. Treasury securities [covered clearing agency]", which are "generally banks and broker-dealers". *See* Standards for Covered Clearing Agencies for Treasuries Final Rule Release, 89 FR at 2717.**

54 **The term "indirect participants" refers to "those entities which rely on a direct participant to clear and settle their U.S. Treasury securities transactions with the U.S. Treasury securities [covered clearing agency]". These entities are "generally [direct participants'] customers or clients, which typically include market participants such as money market funds, hedge funds, other asset managers, and smaller banks or broker-dealers". *Id*.**

55 *See e.g.*, 69 FR 48008 at 48015; and Question 4.7 and 4.8 of the SEC Division of Market Regulation Responses to Frequently Asked Questions Concerning Regulation SHO (October 15, 2015) (SEC's Reg SHO FAQs).

56 *See* Question 4.8 of the SEC Reg SHO FAQs.

57 Exchange Act Rule 15c2-11(e)(7) broadly defines "quotation" as "any bid or offer at a specified price with respect to a security, or any indication of interest by a broker or dealer in receiving bids or offers from others for a security, or any indication by a broker or dealer that wishes to advertise its general interest in buying or selling a particular security." Similarly, Exchange Act Rule 15c2-11(e)(8) broadly defines "quotation medium" to include "any 'interdealer quotation system' or any publication or electronic communications network or other device that is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell."

58 ***See* the Report's Manipulative Trading topic for additional guidance.**

59 ***See* FINRA Rules Series: 6200 (Alternative Display Facility); 6300A (FINRA/NASDAQ Trade Reporting Facilities); 6300B (FINRA/NYSE Trade Reporting Facility); 6380A (Transaction Reporting) for NASDAQ TRFs; 6380B (Transaction Reporting) for NYSE TRFs; 6620 (Reporting Transactions in OTC Equity Securities and Restricted Equity Securities); 7100 (Alternative Display Facility); 7200A (FINRA/NASDAQ Trade Reporting Facilities); 7200B (FINRA/NYSE Trade Reporting Facility); and 7300 (OTC Reporting Facility).**

60 ***See* questions 101.14 and 101.15 of FINRA's Trade Reporting Frequently Asked Questions. In contrast, firms are currently required to report order, route and trade events in NMS stocks and OTC equity securities to the CAT Central Repository, including any fractional share quantity up to six decimal places.**

61 **FINRA may phase implementation of the fractional share reporting enhancements, for example to begin reporting for NMS stocks at an earlier date than for OTC Equity Securities. Firms should report consistent with FINRA systems and notices regarding fractional share reporting.**

62 **See *Regulatory Notice* *21-31* (FINRA Establishes New Supplemental Liquidity Schedule (SLS).**

63 **Firms that neither self-clear nor provide clearing services may designate the same person as the Principal Financial Officer, Principal Operations Officer and Financial and Operations Principal or Introducing Broker-Dealer Financial and Operations Principal (that is, such firms are not required to designate different persons to function in these capacities). See FINRA Rule 1220(a)(4).**

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