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FINRA Report Highlights New Topics and Emerging Risks for 2022.

On February 9, FINRA published its 2022 Report on FINRA's Examination and Risk Management Program (2022 Report), an authoritative resource for member firms to evaluate and, where necessary, enhance their compliance programs and operations procedures. The 2022 Report is just the second iteration of FINRA's pathbreaking annual Report on FINRA's Examination and Risk Management Program, which FINRA describes as an "up-to-date, evolving resource or library of information for firms." The annual report outlines relevant rule(s), key considerations, noteworthy findings, and effective practices on a broad range of regulatory obligations organized into four categories: (1) firm operations, (2) communications and sales, (3) market integrity, and (4) financial management.

The first report (2021 Report) synthesized and supplanted two of FINRA's prior annual publications, bringing together (1) FINRA's analysis of prior examination results, historically provided in the Report on Examination Findings and Observations; and (2) FINRA's forward-looking Risk Monitoring and Examination Program Priorities Letter, which highlighted the issues on which FINRA planned to focus its reviews for the coming year. Building upon the content of the 2021 Report (which we previously covered here), the 60-page 2022 Report includes several new topics, and identifies key areas of emerging risk that may receive increased scrutiny going forward. The 2022 Report also highlights several topics that received significant industry and public attention in 2021, including: (1) new SEC rules, such as Regulation Best Interest and Form CRS; (2) the increasing prevalence and sophistication of cybersecurity attacks; (3) securities trading via mobile applications; and (4) the increased use of special purpose acquisition companies (SPACs) to bring companies public. The 2022 Report states that FINRA will continue to assess member firms' programs and share information on these topics of interest as they develop, including in future annual reports.

Below, we summarize five entirely new topics found in the 2022 Report and catalog the emerging risks that FINRA has identified as likely to receive increased scrutiny in 2022 and beyond. However, FINRA member firms are encouraged to thoroughly review the 2022 Report. In particular, member firms should: (1) pay close attention to the topics that FINRA has flagged as "new" to the 2022 Report; and (2) identify the findings, observations, and effective practices relevant to their business models. The findings and best practices outlined in the 2022 Report can serve as a guide for member firms to evaluate their compliance programs and operations procedures to identify possible deficiencies or gaps that could result in the types of exam findings highlighted therein. The 2022 Report also may serve as a road map to prepare for an examination. If concerns arise before an examination, member firms would be well served by including counsel familiar with these issues in their preparation for the examination.

I. New Topics Covered in the Report

Firm Short Positions and Fails-to-Receive in Municipal Securities. Customers may receive taxable, substitute interest instead of the expected tax-exempt interest when a firm effects sales to customers of municipal securities not under the firm's control — for example, when firm trading

activity inadvertently results in a short position or when a firm fails to receive municipal securities it purchased to fulfill a customer's order. Firms must develop and implement adequate controls and procedures for detecting, resolving, and preventing these adverse tax consequences to customers.

Trusted Contact Persons. FINRA Rule 4512(a)(1)(F) requires firms, for each of their noninstitutional customer accounts, to make a reasonable effort to obtain the name and contact information for a trusted contact person age 18 or older, and describes the circumstances in which firms are authorized to contact the trusted contact person and disclose information about the customer account.

Funding Portals and Crowdfunding Offerings. Funding portals must register with the SEC and become a member of FINRA. Broker-dealers contemplating engaging in the sale of securities in reliance on the crowdfunding exemptions must notify FINRA in accordance with FINRA Rule 4518.

Disclosure of Routing Information. Rule 6060 of Regulation NMS requires broker-dealers to disclose information regarding the handling of their customers' orders in NMS stocks and listed options, so that customers can (1) better understand how the firm routes and handles their orders, (2) assess the quality of order handling services, and (3) ascertain whether the firm is effectively managing potential conflicts of interest.

Portfolio Margin and Intraday Trading. FINRA Rule 4210 permits member firms to apply portfolio margin requirements in margin accounts held by certain investors as an alternative to strategy-based margin requirements. Firms are required to monitor the risk of the positions held in these accounts during a specified range of possible market movements according to a comprehensive written risk methodology.

II. Emerging Risks

Emerging Low-Priced Securities Risk. FINRA has observed an increase in several types of activity in low-priced securities that could be indicative of fraud schemes, including an increase in such activity through foreign financial institutions that open omnibus accounts at U.S. broker-dealers.

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

Emerging Customer Account Information Risks. Effective February 15, 2021, FINRA Rule 3241 requires a registered person to decline being named a beneficiary of a customer's estate, executor, or trustee or to have power of attorney for a customer unless certain conditions are met, due to the risk of a conflict of interest. Among other things, firms should (1) consider whether their policies and procedures establish criteria for a registered person acting in such capacity and (2) be able to perform a reasonable assessment of the risks of a registered person in such a position.

FINRA member firms should thoroughly review the 2022 Report, including the areas highlighted above, to identify the findings, observations, and effective practices relevant to their business models, and they should incorporate relevant practices into existing compliance programs.

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February 17 2022

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