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## FINRA Releases 2015 Broker-Dealer Exam Priorities

On January 6, 2015, the Financial Industry Regulatory Authority (“FINRA”) released its 2015 Regulatory and Examinations Priorities Letter highlighting a number of compliance areas that FINRA examiners will focus on in the coming year. According to FINRA’s 15-page letter, examiners will carefully scrutinize the sales practices of certain complex products, financial and operational priorities such as cybersecurity, and market integrity matters. Below is a brief summary of some of the key exam priorities raised in the 2015 letter. A copy of FINRA’s letter with all of the exam priorities is available on **FINRA’s website**.

### SALES PRACTICES

#### **Sale and Supervision of Complex Products**

FINRA examiners will focus on the sales practices in alternative mutual funds (or “liquid alts”), exchange-traded products tracking alternatively weighted indices, and securities-backed lines of credit. Some of the concerns FINRA has raised with these products include how they are marketed, whether firms are accurately and fairly describing how the products work, and whether firms and their representatives understand how they will respond to various market conditions. Other products that FINRA will be paying close attention to include interest rate-sensitive fixed-income securities, variable annuities, non-traded

REITs, structured retail products, and floating-rate bank loan funds.

#### **New Supervision Rules**

FINRA’s new supervision rules (FINRA Rules 3110, 3120, 3150 and 3170) became effective on December 1, 2014. Those rules modify or impose new obligations with respect to firms’ supervisory systems, WSPs, internal inspections, and transaction reviews and investigations. Examiners will look to see how firms are addressing the new rules and that the new requirements of the rules are being implemented properly.

#### **IRA Rollovers and other “Wealth Events”**

FINRA will focus on how firms handle “wealth events” in investors’ lives, such as inheritances, life insurance payouts, and IRA rollovers. The general compliance areas that examiners will scrutinize in connection with wealth events include supervisory, suitability, and disclosure obligations.

#### **AML**

FINRA will focus on Cash Management Accounts (CMAs) and, for the second year in a row, Delivery Versus Payment/Receipt Versus Payment (DVP/RVP) accounts. FINRA will review, among other things, the adequacy of a firm’s surveillance system and the processes to identify red flags with respect to transactions in these types of accounts.

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### Other Sales Practices Priorities

FINRA also noted concerns with sales practices in the following areas:

- Excessive Trading and Concentration Controls;
- Private Placements;
- High-Risk and Recidivist Brokers;
- Sales Charge Discounts and Waivers;
- Senior Investors; and
- Municipal Advisors and Securities.

### FINANCIAL AND OPERATIONAL PRIORITIES

#### Cybersecurity

Examiners will review firms' approaches to cybersecurity risk management, including their governance structures and processes for conducting risk assessments, and addressing the output of those assessments. FINRA's letter also indicates that FINRA plans to release the results of its 2014 cybersecurity sweep in early 2015.

#### Timely Reporting of Disclosable Information

FINRA noted that it had found a number of instances where firms are failing to report disclosable information (e.g., regulatory actions, complaints, bankruptcy filings, liens, judgments) or are failing to report such information in a timely manner. The letter also reminded firms of amended

Rule 3110, which becomes effective July 1, 2015, requiring firms to perform public records checks to verify the accuracy of representative's Form U4s.

### Other Financial and Operational Priorities

FINRA noted concerns with financial and operations controls in the following areas:

- Funding and Liquidity: Valuing Non-High-Quality Liquid Assets;
- Sales to Customers Involving Tax-Exempt or Federal Deposit Insurance Corporation; (FDIC)-Insured Products; and
- Outsourcing.

### MARKET INTEGRITY

#### Abusive Algorithms

FINRA's letter referred to abusive algorithmic trading and deficient supervision for manipulation in this area as one of the most significant risks to market integrity. As a result, examiners will continue their recent efforts in assessing whether firms' testing and controls relating to algorithmic trading strategies are adequate.

#### Order Routing Practices, Best Execution and Disclosure

FINRA will continue to examine firms' order-routing and best execution practices, and noted that it is still in the process of conducting its order routing sweep launched in 2014 focusing on routing decisions and whether such decisions were

impacted by rebates. FINRA also noted that it is focusing on best execution failures and other trading issues associated with option orders and fixed-income securities.

### Other Market Integrity Priorities

FINRA noted concerns with the following market integrity issues:

- Supervision and Governance Surrounding Trading Technology;
- Cross-Market and Cross-Product Manipulation;
- Market Access;
- Audit Trail Integrity.

FINRA's letter identifies five "recurring challenges" that examiners have encountered over the years, such as firms failing to place customers' interests first and failing to create a culture of compliance. According to FINRA, properly addressing these broad challenge areas should enable firm's to get ahead of many of the more specific concerns raised in the 2015 letter.

Please feel free to contact us if you have any questions regarding FINRA's 2015 Regulatory and Examinations Priorities Letter or any related matter.