

FINRA 2018 Exam Findings Report and Regulatory Update Reminder



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I. Exam Findings Report (2018)

Overview

On December 7, 2018, FINRA released their annual Exam Findings Report. This is an important tool for Member Firms to leverage when prioritizing their compliance initiatives for 2019. CRC has reviewed this report and summarized key takeaways, below.

Summary

In the report, FINRA states, “[t]his report focuses on selected observations from recent examinations that FINRA considers worth highlighting because of their potential significance, frequency, and impact on investors and the markets.” As in years past, FINRA placed a priority on issues stemming from areas like AML, accuracy of net- capital calculations, liquidity, segregation of client accounts, and best execution. In keeping with the theme of previous reports from recent years, FINRA remains focused on customer protection.

In general, issues arose when dealing with products other than typical stocks and bonds. The report makes clear that FINRA equates less “mainstream” products with increased risk to consumers. Likely driven by increased activity and interest surrounding digital currency this year, the regulator focused on products that it considers to be “complex” or “high-risk,” primarily because they stray from the beaten path and therefore hold a greater potential to cause confusion and possible harm to investors. The list includes products such as leveraged and inverse ETFs and ETNs, variable annuities, UITs, REITs, volatility-linked products, and private placements.

FINRA’s conservative solution to mitigating the risk of such products to a Member Firm’s business or clients is to avoid them altogether. Although the report includes various instances in which Firms successfully implemented reasonably designed controls to mitigate the risks inherently present when dealing with lesser-known or understood products, they reference more frequently the notion that many firms are simply deciding to avoid these products altogether, further highlighting their point on view on the matter.



Conclusion

FINRA's "bread and butter" issues were still at play in 2018- AML, liquidity, investor protection across firm-wide functions and activities- and they will be in 2019 as well. New to the list is the regulator's hyper-focus on complex products and the adequacy of controls surrounding them. Firms may choose to take the conservative path of avoidance championed (however subtly) by FINRA in the 2018 Exam Findings Report; for those who decide to continue or wish to begin offering such products, CRC recommends partnering with an experienced regulatory compliance partner to assist in navigating the ever-evolving regulatory landscape and implementing industry best practices and adequate policies and procedures to satisfy both regulators and clients.

II. Regulatory Update & Reminder

Per FINRA Notice 17-30, effective October 1, 2018, firms are required to designate both a Principal Financial Officer and Principal Operations Officer:

- a. Principal Financial Officer with primary responsibility for financial filings and the related books and records; and
- b. Principal Operations Officer with primary responsibility for the day-to-day operations of the business, including overseeing the receipt and delivery of securities and funds, safeguarding customer and firm assets, calculation and collection of margin from customers and processing dividend receivables and payables and reorganization redemptions and those books and records related to such activities.

This requirement replaces the current requirement that FINRA members designate a CFO.

The requirement to designate a Principal Financial Officer and a Principal Operations Officer applies to all firms. Further, individuals designated as Principal Financial Officers or Principal Operations Officers must qualify and register as Financial and Operations Principals (Series 27).

Principal Financial Officers and Principal Operations Officers must also be registered in the CRD system as Operations Professionals because their activities and responsibilities intersect with those of covered persons as specified in FINRA Rule 1220(b)(3). However, individuals designated as Principal Financial Officers and Principal Operations Officers are not required to pass the Operations Professional (Series 99) examination in order to register as Operations Professionals, if they already hold a qualifying registration. Moreover, because Principal Financial Officers and Principal Operations Officers are required to be registered as Financial and Operations Principal (Series 27) or Introducing Broker-Dealer Financial and Operations Principals (Series 28), they will be eligible to register as Operations Professionals as these registrations qualify for the Operations Professional registration.



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 (that is, such firms are not required to designate different persons to function in these capacities). Firms that are clearing and self-clearing must designate separate persons to function as Principal Financial Officer and Principal Operations Officer, though such individuals may also carry out the responsibilities of a Financial and Operations Principal.

Compliance Risk Concepts (CRC) is a business-focused, team of senior compliance consultants and executives providing clients with the critical skills and expertise required to establish, maintain and enhance a balanced and effective compliance operational risk management program. With headquarters in New York, NY, and offices in Irvine CA, Chicago IL, and Houston TX, CRC is your full-service Compliance Risk Management support partner. Learn more: <http://compliance-risk.com/>.

Feel free to contact **Mitch Avnet** at mavnet@compliance-risk.com with any questions or to schedule a call / meeting to further determine your individualized needs and requirements.



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Kaitlyn Gibbs joined CRC in 2017. She is a regulatory compliance professional with 7 years of experience in the financial services industry. Kaitlyn has extensive knowledge of the rules of the Investment Company Act of 1940 and the Investment Advisers Act of 1940. She previously managed compliance processes and performed forensic testing in her role as Compliance Analyst at Welch & Forbes LLC.

She has experience performing annual reviews and risk analyses, regulatory research, as well as Code of Ethics administration. Her primary focus areas include, process implementation and enhancement, cybersecurity, marketing materials review, private equity investment compliance, and investment portfolio compliance.



Most recently at CRC, Kaitlyn has performed regulatory research, evaluated compliance programs, and performed annual reviews and risk assessments for investment advisors.

Kaitlyn holds a Bachelor's Degree in English from Boston University.



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