KPMG

Regulatory Alert

Financial Services Regulatory Insight Center

January 2019

FINRA releases 2019 Risk Monitoring and Examination Priorities

Key points

— In contrast to previous years, FINRA's 2019 Priorities Letter focuses on "materially new priorities," including online distribution platforms, fixed-income mark-up disclosures, and regulatory technology.

— In other "areas of ongoing concern," FINRA highlights aspects of those areas that represent a "new" emphasis.

— FINRA will also continue to review for compliance more broadly in the "areas of ongoing concern," and encourages firms to use the 2019 Priorities Letter in conjunction with other reports to enhance their compliance, supervisory, and risk management programs.

FINRA has released its 2019 Risk Monitoring and Examination Priorities Letter (2019 Priorities Letter) highlighting topics that it refers to as "materially new areas" of focus for risk monitoring and examination programs. These "materially new areas" include:

— **Online distribution platforms**. FINRA is concerned that some member firms may be selling or recommending securities when involved with online distribution platforms despite assertions to the contrary. In this regard, FINRA will evaluate reasonable basis and specific customer suitability analyses, the completeness and accuracy of communications with the public, and compliance with anti-money laundering (AML) requirements as well as certain requirements related to sales to non-accredited investors and disclosures of compensation arrangements between firms and issuers.

— **Fixed income mark-up disclosure**. FINRA will review for compliance with mark-up and mark-down disclosure obligations on fixed income transactions consistent with amendments to FINRA Rule 2232 and MSRB Rule G-15, which became effective in May 2018.

— **Regulatory technology**. FINRA will "engage with firms" to understand how they are using innovative regulatory technology to meet their compliance requirements as well as how they are addressing related risks, including issues of supervision and governance, third-party vendor management, safeguarding of customer data, and cybersecurity.

FINRA also outlines new aspects within "areas of ongoing concern" that it will emphasize in 2019. Highlights of these new areas follow. (Note that the "areas of ongoing concern" have been discussed in FINRA's previous letters and FINRA indicates it will also continue to review these areas more generally for compliance.)

Sales practice risks

— **Suitability**, including quantitative determinations, over-concentrations in illiquid securities, and recommendations to purchase share classes that are not in line with a customer's investment time horizon or to be held for a period of time inconsistent with the security's performance characteristics. FINRA will also be looking at suitability in the context of complex products, such as leveraged and inverse exchange-traded funds (ETFs), floating rate loan ETFs, and certain mutual fund investments.

— **Senior investors**, including protections against fraud, sales practice abuses, and financial exploitation. FINRA will review firms' application of the new FINRA rules covering the naming of trusted contacts and the placing of temporary holds (FINRA Rules 2165 and 4512). FINRA will also be looking at accounts where registered representatives serve in a fiduciary capacity with non-familial customer accounts and related supervisory systems.

Operational risks

— **Supervision of digital assets business**. Working with the SEC, FINRA will consider how firms determine if a particular digital asset is a security and whether firms have implemented adequate controls and supervision over compliance with rules related to marketing, sales (including suitability), execution control, clearance, recordkeeping, and valuation in addition to AML/Bank Secrecy Act rules and regulations.

— **Customer Due Diligence and Suspicious Activity Reviews**. Reviews will focus on the data integrity of suspicious activity monitoring systems "as well as the decision associated with changes to those systems" to comply with FinCEN's Customer Due Diligence rule, which became effective in May 2018.

Market risks

— **Best execution**, and in particular, instances where firms have routed all or substantially all customer orders to a small number of wholesale market makers, or an affiliated broker-dealer or an alternative trading system in which the firm had a financial interest.

— **Market manipulation**, focusing on manipulative trading in correlated exchange traded products (ETPs), including those that track broad market indices. FINRA intends to use pattern exploration and expand the use of machine learning to react to changes in the ETP market.

Financial risks

— **Credit risk**, including exposures created by transactions a firm's customers and correspondents execute "away" from the firm, without the firm's participation until after execution. Such responsibility may be incurred under clearing, prime brokerage, give up, or sponsored access arrangements. FINRA will also look at credit risks associated with customer margin accounts that contain illiquid, volatile, or concentrated securities positions, products, or strategies.

— **Funding and liquidity**, focusing on stress test assumptions.

Additional areas of ongoing concern not covered by the 2019 Priorities Letter but highlighted as focal areas in 2019 include risks related to the hiring and supervision of "associated persons with problematic regulatory history," and the adequacy of firms' cybersecurity programs. FINRA directs firms to its previous reports for additional information on practices to strengthen programs and enhance compliance. These reports include its Report on Selected Cybersecurity Practices (see KPMG Regulatory Alert) and its 2019 Reports on Examination Findings (see KPMG Regulatory Alert).

For additional information, please contact Tracy Whille or Bill Meehan.

Amy Matsuo
Principal and National Lead
Regulatory Insights
T: 919-664-7302
E: amatsuo@kpmg.com

Contributing authors:

Amy Matsuo, Principal and National Lead, Regulatory Insights

Karen Staines, Director, Financial Services Regulatory Insight Center

Phil MacFarlane, Associate Director, Financial Services Regulatory Insight Center

kpmg.com/socialmedia