

INVESTMENT MANAGEMENT

FINRA ANNOUNCES 2017 EXAMINATION PRIORITIES

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Each year the Financial Industry Regulatory Authority (“FINRA”) issues a release identifying various areas in which FINRA plans to focus its efforts in their examinations. FINRA published its Annual Regulatory and Examination Priorities Letter (the “Priorities Letter”) on January 4, 2017 identifying the areas that will receive increased focus in FINRA’s 2017 examinations. FINRA’s examination priorities reflect new areas of focus, while still scrutinizing areas that continue to engage FINRA. The FINRA Priorities Letter may be found [here](#).

FINRA’s 2017 Annual Regulatory and Examination Priorities Letter

The Priorities Letter offers guidance for FINRA-regulated members regarding the areas that the agency will pay most attention to this year. Though FINRA will focus on the issues discussed below, we caution clients that this is not an exhaustive list. FINRA will continue to use its regulatory program to monitor other areas beside those addressed in the Priorities Letter. As such, we advise that all FINRA-regulated clients not only familiarize themselves with the Priorities Letter, but also familiarize themselves with past priorities letters and other FINRA guidance, to best ensure compliance with applicable rules and regulations. Of course, we are available to help you develop policies and compliance programs to meet FINRA’s requirements.

High-Risk and Recidivist Brokers

FINRA will focus on firms’ hiring and monitoring of high-risk and recidivist brokers, including whether firms establish appropriate supervisory and compliance controls for such persons.

Sales Practices

Senior Investors

As in prior years, FINRA will continue to closely monitor transactions involving senior investors and communications with them. In doing so, FINRA seeks to ensure that firms maintain appropriate supervisory mechanisms to detect and prevent problematic sales practices with respect to senior investors.

Product Suitability and Concentration; Excessive Trading of Long-Term Products

Ensuring that firms conduct reasonable-basis and customer-specific suitability reviews remains important while FINRA further expands its review to focus on the controls firms use to monitor recommendations that could result in excess concentration in customers’ accounts.

Firms should expect their ability to monitor short-term trading of long-term products to be scrutinized in 2017. These include products such as mutual funds and variable annuities, which were a product focus of enforcement in 2016. Relatedly, FINRA is strongly

recommending that firms evaluate whether their supervisory systems are able to detect activity intended to evade automated surveillance for excessive switching activity.

Outside Business Activities and Private Securities Transactions

Each year firms’ obligations to approve and supervise the outside business activities and private securities transactions of their registered representatives are of continued importance to FINRA. FINRA will also continue to analyze firms’ procedures in reviewing the written notifications of proposed outside business activities and proposed private securities transactions of their registered representatives. Such activities could compromise a registered person’s responsibilities to the firm’s customers by creating conflicts of interest or they could be viewed as part of the firm’s business.

Social Media and Electronic Communications Retention and Supervision

FINRA will review firms’ compliance with their supervisory and record-retention obligations with respect to social media and other electronic communications (irrespective of the medium, network, or device used to communicate) in light of the increasingly important role they play in the securities business.

Financial Risks

Liquidity Risk and Financial Risk Management

In 2017, FINRA will review firms' funding and liquidity plans to assess whether the firms adequately evaluate their liquidity needs related to market-wide and idiosyncratic stresses. It will also investigate whether they develop contingency plans to endure those stresses by conducting stress tests and other reviews to evaluate the effectiveness of the contingency plans so as to ensure firms maintain sufficient liquidity at all times.

FINRA will ask a select group of firms to explain how they would react to a specific stress test scenario that could affect a firm's market, credit, and liquidity risk. FINRA will assess these select firms' risk management practices by focusing on areas such as readiness, communication plans, risk metrics and triggers, and contingencies.

Operational Risks

Cybersecurity and Anti-Money Laundering Monitoring

FINRA will continue to assess various firms' programs to mitigate the risks associated with cybersecurity threats, taking into account each firm's business model, size, and risk profile, among other factors. Recently, FINRA has grown more concerned with observed shortcomings in cybersecurity controls at branch offices and more generally with respect to use of passwords, encryption of data, and other related areas. FINRA has also noticed a wider trend of firms failing to comply with certain electronic record-keeping obligations, namely the requirement to preserve certain records in a non-rewriteable, non-erasable write once read many (WORM)

format pursuant to Rule 17a-4(f) of the Securities Exchange Act of 1934, as amended (the "Exchange Act").

FINRA has been concerned with anti-money laundering ("AML") for the past few years; 2017 is no exception. Of particular import this year are gaps in firms' automated trading and money movement surveillance systems, which may be caused by data integrity problems, poorly set parameters, or surveillance patterns that do not capture problematic behavior or other types of suspicious activities, including those linked to transactions in microcap securities. FINRA brought several enforcement actions relating to these types of AML issues in 2016 and these remain a topic with which FINRA is focused.

Other Areas of Interest

Other areas of concern for FINRA in 2017 are: firms' market access controls in accordance with the Market Access Rule; firms' duties of best execution; firms' supervisory procedures and systems to monitor for manipulative conduct; trading examinations of smaller, never-before-examined firms; segregation of client assets in accordance with Rule 15c3-3 of the Exchange Act; firms' supervisory controls testing; registration of municipal advisors; credit risk policies, procedures, and risk limit determinations under FINRA Rule 4210; FINRA's use of its Order Audit Trail System to detect and deter market manipulation; FINRA's Audit Trail Reporting Early Remediation Initiative; data requirements of the Tick Size Pilot; compliance with Regulation SHO; firms' data integrity programs; and the accuracy of submitted data related to transactions in U.S. Treasury securities, among others.

Lowenstein Sandler's Investment Management Group is available to answer any questions relating to the Priorities Letter and your business. Similarly, we are available to assist you in developing best-in-class policies and compliance programs for your firm in accordance with all applicable rules and regulations and industry standards. FINRA regulated members should take care to re-examine their existing compliance program in light of the Priorities Letter.

In the interim, please contact any of the authors of this article, or any other member of Lowenstein Sandler's Investment Management Group, for further information on the matters discussed in this alert or with any questions you may have regarding compliance with FINRA rules and regulations.

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