

FINRA Targets Brokers Hawking Crypto

By **Jessica Corso**

Law360 (November 17, 2022, 8:54 PM EST) -- The Financial Industry Regulatory Authority is examining approximately 20 brokerage firms it believes may be advertising cryptocurrencies to retail investors, saying that it is already aware that some firms are not properly communicating the risks of such investments.

FINRA announced in a website post this week that it is conducting a targeted sweep of its members looking for any communications with retail customers about crypto products that were made during the third quarter.

The self-regulatory organization didn't name the firms being targeted nor say how long they will have to answer the set of five questions being posed, but FINRA spokesperson Ray Pellecchia said the results of the examinations will be made public.

Among other things, FINRA is asking for retail communications distributed or made available by brokers or their affiliates that relate to or concern a crypto asset or service.

It also wants to know when those communications were made and whether FINRA's Advertising Regulation Department was informed of the communications.

Pellecchia said that the organization was concerned that retail investors were not being informed that they may have limited protection under current securities laws when investing in digital assets, as Securities Investor Protection Corporation coverage or segregation of client assets may not apply to them.

"This risk is not hypothetical," he said. "The limited number of crypto-asset-related communications filed with FINRA by broker-dealer firms fail to comply with applicable standards at a significantly higher rate than communications for other products."

He also said the potential for "misrepresentations or exaggerated claims" to cause harm has increased as the number of people holding such coins also increases.

While FINRA didn't mention failed crypto exchange FTX in its public statements on the probe, it's hard to ignore the shadow the company's downfall has cast on the industry as a whole.

The company entered bankruptcy last week after customers attempted to withdraw \$6 billion in a single

day due to a now-confirmed report that founder Sam Bankman-Fried had commingled the finances of FTX and his trading firm, Alameda Research.

In a court filing Thursday, FTX's new CEO, John R. Ray III, who shepherded Enron after its spectacular collapse, said he had never seen "such a complete failure of corporate controls."

Morgan Lewis & Bockius LLP posted about FINRA's targeted exam on its website Wednesday because of the timing of its release, partner Ignacio Sandoval told Law360.

"Is it coincidental? Perhaps," Sandoval said about the FINRA notice. "I think the fact that it's coalescing around a lot of issues happening in the crypto industry right now, that we need to highlight this. Firms really need to be cognizant about how they're going to respond if they actually did get this letter."

Sandoval, who advises broker-dealers on their FINRA obligations, said one thing that stood out to him about the notice was the organization's definition of communications.

Aside from any written communication, FINRA is also targeting communication posted to social media sites or through smartphone applications where retail consumers frequently trade cryptocurrencies.

It's important to note that many brokerage firms cannot offer cryptocurrencies but may have affiliates that do so under the same name, Sandoval said. The distinction isn't always clear for retail customers.

"I think that's why they're honing in on this," Sandoval said. "Because when the communications go out, the broker-dealer and the crypto affiliate, or even the advisory affiliate, they're all effectively using the same trade name."

"I think what FINRA is going to be honing in on here is: Is it distinguished enough for the average retail investor to know who the communication is coming from?" he said.

--Editing by Emily Kokoll.