Securities Industry and Financial Markets Association

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Ask FINRA*

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* This outline was drafted by Ben A. Indek, Ariel Gursky and Elizabeth Buechner of Morgan, Lewis and Bockius LLP; certain information appeared in the outline used for this panel in previous C&L Society Seminars. This outline does not represent the views of the other panelists or their organizations. This outline is current as of February 5, 2016.

I. Rulemaking Initiatives and the Status of Proposed and Recently Effective Rules

A. Financial Exploitation of Seniors and Other Vulnerable Adults

1. In October 2015, FINRA released Regulatory Notice 15-37, seeking comments on proposed rules relating to financial exploitation of seniors and other vulnerable adults.

2. FINRA proposed changes to Rule 4512 (Customer Account Information). These changes would require firms to make reasonable efforts to assign a trusted contact upon opening an account for a non-institutional customer. Regarding existing accounts, the rule requires obtaining information for a trusted contact only if a firm were to update a customer's account information as part of their routine processes or as otherwise required by applicable rules. Changes to Rule 4512 also require firms to disclose in writing their ability to contact the trusted contact and disclose account information to confirm the account holder's information, health status, and identity of legal guardian or other person holding similar status.

3. FINRA also proposed the adoption of Rule 2165 (Financial Exploitation of Specified Adults), which would permit "qualified persons" to place temporary holds on the accounts of certain customers, if they reasonably believe that financial exploitation is occuring. Customers who may fall under Rule 2165 included individuals who are 65 or greater or individuals with mental or physical impairments. "Qualified persons" include associated persons of a firm who are related to an account and serve in a supervisory, compliance or legal capacity. "Financial exploitation" is broadly defined.

4. The comment period expired on November 30, 2015. FINRA received 40 comment letters in response to the notice.

5. Finally, FINRA identified "Seniors and Vulnerable Investors" as an area of focus in its 2016 Regulatory and Examination Priorities Letter.

B. Recruitment Practices

1. In January 2013, FINRA requested comments on a proposed rule to require disclosure of conflicts of interest relating to recruitment compensation practices in Regulatory Notice 13-02. The comment period expired on March 5,

2013. FINRA received 65 comment letters in response to the notice.

2. As originally proposed in Regulatory Notice 13-02, the "recruitment compensation" rule would have required a firm that provides, or agrees to provide, certain additional compensation to a registered representative to leave his or her current firm and join the recruiting firm to disclose the details of the additional compensation to any former customer of the registered representative (i) who is contacted about transferring his or her accounts to the registered representative's new firm or (ii) who decides, without having been contacted, to transfer assets to the new firm.

3. On March 10, 2014, FINRA filed SR-FINRA-2014-10 with the SEC, proposing to adopt FINRA Rule 2243 (Disclosure and Reporting Obligations Related to Recruitment Practices).

4. Rule 2243, as proposed, would have required member firms to (i) disclose in ranges additional compensation of $100,000 or greater when soliciting former customers of a newly hired registered representative and (ii) to report to FINRA when they expect compensation paid to new recruits to exceed the greater of a 25% or $100,000 increase from the previous year.

5. On March 28, 2014, the proposal was published for comment in the Federal Register, and FINRA received 189 comments. On June 20, 2014, FINRA withdrew proposed Rule 2243 (SR-FINRA-2014-10), deciding that more time was necessary to consider all comments.

6. On September 19, 2014, FINRA announced that the Board of Governors authorized FINRA to publish a Regulatory Notice soliciting comment on a revised proposal that would require a recruiting firm to provide a FINRA-created educational communication to former retail customers of a transferring representative who are considering transferring assets to that firm.

7. On December 16, 2015, FINRA filed SR-FINRA-2015-057 with the SEC to propose the adoption of Rule 2273, which would require a firm to deliver a FINRA-created educational communication in connection with its recruitment practices and account transfers. The requirement would be triggered when a representative contacts former customers to

encourage their transfer of assets to the representative's new firm.

C. Debt Research

1. FINRA initially published for comment a debt research proposal in Regulatory Notice 12-09. FINRA received seven comment letters in response to the notice.

2. FINRA later published for comment a revised debt research proposal in Regulatory Notice 12-42. The comment period expired on December 20, 2012. FINRA received five comment letters.

3. The debt research proposal included a tiered approach, a key difference from FINRA's equity research rules where Sarbanes-Oxley precludes an institutional exemption.

4. Certain "top tier" institutional investors, those that meet the definition of QIB and satisfy certain suitability requirements, could receive institutional debt research upon receipt of a negative consent letter.

5. Other, non top-tier, institutional investors could receive institutional debt research only after providing the member firm affirmative written consent.

6. Pursuant to the proposal, retail investors could not elect to receive institutional debt research, whether or not they provide the firm with affirmative written consent.

7. On November 14, 2014, FINRA filed with the SEC a proposed rule change to adopt new FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports) to address conflicts of interest relating to the publication and distribution of debt research reports. On November 18, 2014, the SEC issued Release No. 34-73623 requesting comment on proposed Rule 2242. The proposed rule change reflected feedback from the two proposals in Regulatory Notice 12-09 and Regulatory Notice 12-42, as well as extensive discussions with industry participants. The SEC approved the adoption of FINRA Rule 2242 in August 2015. Rule 2242 will become effective on February 22, 2016.

8. The Rule includes a definition of "debt research report" that parallels the definition in Regulation AC. As with the equity rules, the definition applies to any communication, irrespective of its origin, and therefore desk analysts and

strategists who produce debt research reports are considered "debt research analysts" for purposes of Rule 2242. The Rule provides an exemption from many of the rule provisions for institutional debt research. The exemption is intended in part to facilitate the ability of desk analysts who produce "debt research reports" to provide timely information and trading ideas to eligible institutional investors. A firm may not rely on the institutional exemption if it has reason to know the research will be redistributed to a retail investor.

9. Rule 2242 requires firms to establish written policies and procedures to identify and manage conflicts of interests throughout the process of creating and distributing debt research reports. In addition, the Rule requires certain disclosures in retail debt research reports, such as whether the debt research analyst or a household member has a financial stake in the subject company. The Rule also details the prohibition on joint due diligence, requires firms to develop policies and procedures designed to prevent selective distribution of debt research reports to certain trading personnel or customers, and prohibits the dissemination of third-party debt research if the member knows or has reason to know that the research lacks objectivity or reliability.

D. Customer Account Statements

1. On April 24, 2014, the FINRA Board of Governors authorized FINRA to publish a Regulatory Notice soliciting comment on proposed new FINRA Rule 2231 (Customer Account Statements).

2. FINRA published for comment a revised proposal in Regulatory Notice 14-35 seeking to transfer current NASD Rule 2340 and Incorporated NYSE Rule 409 into the consolidated FINRA rulebook as FINRA Rule 2231.

3. The proposal maintained the quarterly delivery requirement in the current rule; and allowed customers to direct the transmission of customer account statements and other documents to third parties, provided the firm sends duplicates of the statements and/or documents directly to the customer.

4. In January 2015, FINRA released Regulatory Notice 15-02 to announce that the SEC had approved amendments to NASD Rule 2340(c).

   a. NASD Rule 2340 requires that general securities members provide regular statements to customers that contain the following information: securities, money balances, and account activity. Paragraph (c) requires statements to show the per share estimated values for direct participation program (DPP) and unlisted real estate investment trust (REIT) securities held by customers or included on account statements.

   b. The amendments require that these per share estimated values be developed in a manner "reasonably designed to ensure that the per share estimated value is reliable." Two methodologies are provided for calculating per share estimated values: the net investment methodology and the appraised value methodology. If a member uses the net investment methodology, it must provide additional disclosures relating to the return of investors' capital

E. Discretionary Accounts and Transactions

1. In June 2015, FINRA released Regulatory Notice 15-22, seeking comments on a proposal to adopt a consolidated FINRA rule regarding discretionary accounts and transactions.

2. The proposal seeks to consolidate certain NASD rules to require that, with respect to discretionary transactions by firms and associated persons:

   a. firms obtain a customer's prior written authorization, signed and dated, that identifies a date discretionary authority was granted;

   b. a customer's written authorization be provided to a named associated person;

   c. a designated partner, officer or manager of a firm denote that the account was accepted according to the firm's policies and sign appropriate account documentation; and

d. the associated person and firm exercise discretionary power over an account only as specified in the customer's written authorization.

3. The proposed rule also seeks to implement certain requirements that apply to transactions by agents of customers. Specifically, the rule would require a written, signed authorization and orders placed by an agent must be within the scope as laid out in that authorization.

4. The comment period expired on August 17, 2015. FINRA received 11 comment letters in response to the notice.

F. Equity Trading and Fixed Income

1. On September 19, 2014, FINRA announced that its Board of Governors approved a series of proposed rule changes regarding equity trading and fixed income. The Board authorized the issuance of a series of Regulatory Notices in this important area. Since that time, FINRA has published several rule proposals. These potential rule changes are discussed below.

a. Registration of Associated Persons Involved in the Preparation of Algorithmic Strategies

i. In March 2015, FINRA published Regulatory Notice 15-06, seeking comment on a proposal to establish a registration requirement for associated persons who are: (1) primarily responsible for the design, development or directing the significant modification of an algorithmic strategy; or (2) responsible for supervising or directing such functions. The comment period expired May 18, 2015. FINRA received six comment letters in response to Regulatory Notice 15-06.

b. Expansion of ATS Transparency

i. In November 2014, FINRA published Regulatory Notice 14-48 to seek comment on a proposal to expand FINRA's recently implemented transparency initiative that discloses Alternative Trading System (ATS) volume to publish the remaining equity volume executed over the counter (OTC). The comment period expires on February 20, 2015.

ii. On January 17, 2014, the SEC, in Exchange Act Release No. 34–71341, approved FINRA rule filing SR-FINRA-2013-042 requiring any registered ATS to make certain weekly trade data reports to FINRA ("Reporting Requirement") and to acquire and use a single, unique MPID when reporting information to FINRA ("MPID Requirement"). The Reporting Requirement was implemented on May 12, 2014, and the MPID Requirement was implemented on February 2, 2015.

iii. The Reporting Requirement, FINRA Rule 4552, requires any ATS to report to FINRA aggregate weekly volume information and number of trades, by security, in both equity securities and TRACE eligible debt securities. Under the rule, an ATS must include only those trades executed within the ATS. This does not include trades routed away for execution, and precludes separate or double counting of the buy and sell side of a trade (e.g., any cross should be reported only once).

iv. FINRA publishes the reported volume and trade count information for equity securities on its website. Pursuant to a proposed rule change, as announced in Regulatory Notice 14-48, FINRA considered publishing the remaining equity trading volume executed OTC by each firm on a security-by-security basis. According to FINRA, the proposed rule would provide additional transparency into a significant portion of the OTC market by enabling market participants and investors to get a better understanding of each firm's OTC trading.

v. In Regulatory Notice 15-48, published in November 2015, FINRA announced that the SEC approved the amendments described in Regulatory Notice 14-48.

vi. The MPID Requirement, the result of amendments to FINRA Rules 6160, 6170, 6480 and 6720, requires each ATS to acquire and use a single, unique MPID when reporting information to FINRA. A firm is not permitted to use multiple MPIDs for a single ATS, and firms that operate multiple ATSs must obtain unique MPIDs for each ATS. Additionally, Firms must notify FINRA before changing the manner in which they use an MPID that they designate for ATS reporting (such as repurposing an MPID for non-ATS activity). Any ATS MPID must be used both for trade reporting and for Order Audit Trail System reporting.

c. Clock Synchronization

i. In November 2014, FINRA published Regulatory Notice 14-47, seeking comment on a proposed requirement that firms synchronize their computer system business clocks to the National Institute of Standards and Technology (NIST) atomic clock within an allowable drift of between 50 to 200 milliseconds. The comment period expired on February 20, 2015. FINRA received 8 comment letters in response to the notice.

d. Supervision of Algorithmic Trading Strategies

i. In March 2015, FINRA published Regulatory Notice 15-09 to provide guidance on its views of effective supervision and control practices for firms engaging in algorithmic trading strategies. FINRA noted that firms must have policies and procedures to review and test trading algorithms used, including post-implementation monitoring of algorithmic strategies. The notice provided a list of recommendations for effective supervision and control practices for firms, including that firms:

a) holistically review trading activity and create a committee to assess and react to risks of algorithmic strategies;

b) monitor software/code development and implementation;

c) conduct testing of algorithmic strategies prior to putting them into production;

d) develop policies and procedures that include reviewing trading activity after an algorithmic strategy is put into place or has been changed; and

e) create mechanisms for effective communication between developers of algorithmic strategies and compliance staff.

e. Trade Sequencing

i. In November 2014, FINRA published Regulatory Notice 14-46, seeking comment on a proposal to identify OTC trades in NMS stocks reported more than two seconds following trade execution as "out of sequence," and therefore not "last sale" eligible, for purposes of public dissemination. The comment period expired on February 20, 2015. FINRA received three comment letters in response to the notice.

f. Fixed Income Pricing Disclosure

i. In a speech given on June 20, 2014, SEC Chair Mary Jo White broadly identified several initiatives to address investor concerns in the fixed income markets. Among other things, Chair White said that the SEC would work with FINRA and the Municipal Securities Rulemaking Board (MSRB) to develop rules regarding the disclosure of mark-ups in “riskless principal” transactions for both corporate and municipal bonds to help customers assess the reasonableness of their dealer’s compensation.

ii. In November 2014, FINRA published Regulatory Notice 14-52, seeking comment on a proposed rule that would require firms to disclose additional information on customer confirmations for transactions in fixed income securities. Specifically, the proposed rule would require that for same-day, retail-size principal transactions, firms disclose the price to the customer, the price to the member of a transaction in the same security, and the differential between those two prices.

iii. The MSRB also published a notice soliciting comment on a similar proposal, and suggested coordinating its approach with FINRA.

iv. In October 2015, in response to comments received on Regulatory Notice 14-52, FINRA announced a revised proposed rule in Regulatory Notice 15-36. Changes from the prior proposal include using a retail customer account standard instead of a size-based disclosure threshold, allowing firms to use alternate methodologies to calculate the reference price for complex trades, and requiring firms to include a link to TRACE on confirmations. The comment period closed on December 11, 2015 and FINRA received 18 comment letters in response to its proposal.

v. The MSRB published Regulatory Notice 2015-16 to announce a modified proposal that differs from FINRA's revised proposal. Changes from the prior MSRB proposal include replacing a disclosure requirement for pricing reference information with a mark-up disclosure requirement. FINRA Regulatory Notice 15-36 also requested comments on the MSRB's new approach.

g. Fixed Income Quotation Information

i. In February 2015, FINRA requested comments on proposed rules to require ATSs to submit quotation information for corporate and agency debt securities. *See* Regulatory Notice 15-03. This information would be used only for regulatory and surveillance purposes. The comment period expired April 7, 2015. FINRA received six comment letters in response to the notice.

2. In September 2015, the Board authorized FINRA to file proposed amendments to the Rule 6500 series with the

SEC. The amendments would seek to establish a back-up quotation display facility for OTC equity securities.

G. Self-Trading

1. On May 2, 2014, FINRA announced the SEC's approval of FINRA Rule 5210 to limit self-trading. Effective August 25, 2014, firms must have policies and procedures in place that are reasonably designed to review trading activity for, and prevent, a pattern or practice of self-trades

2. According to FINRA, self-trades raise heightened concerns because this type of trading may not reflect genuine trading interest, particularly if there is a pattern or practice of such trades.

3. In March 2015, FINRA published Regulatory Notice 15-09 to provide guidance to firms engaging in algorithmic trading strategies. FINRA recommended that firms develop compliance monitoring tools that cover activity resulting from the interaction of multiple algorithms, such as self-trades.

H. Equity Trade Reporting and OATS Rules

1. In Regulatory Notice 14-21, published in May 2014, FINRA announced that the SEC had approved amendments to FINRA rules governing the reporting of: (i) OTC transactions in equity securities to the FINRA facilities; and (ii) orders in NMS stocks and OTC equity securities to the Order Audit Trail System (OATS).

2. FINRA rules previously required that trade reports submitted to the FINRA facilities include the time of trade execution, except where another time is expressly required by rule. The amendments require firms to reflect two times in reports of stop stock transactions and transactions that reflect an execution price that is based on a prior reference point in time (PRP transactions). Specifically, firms are required to report: (1) the time at which the parties agree to the stop stock price or the prior reference time; and (2) the actual time of execution.

3. In addition, the amendments require firms to include two times when reporting block transactions using the exception for Intermarket Sweep Orders (ISOs) (outbound) under SEC Rule 611 (Order Protection Rule) of Regulation NMS if the time the firm routed the ISOs is different from the execution time. Specifically, firms are required to report the time that

all material terms of the transaction are known in the "execution time" field, as they currently do. In the new time field, firms should also report the time they used to determine any ISOs to route to any better-priced protected quotations (i.e., the time the firm takes a "snapshot" of the market).

4. FINRA trade reporting rules, as well as the OATS rules, require firms to report execution times in terms of hours, minutes and seconds (*i.e.*, HH:MM:SS). Pursuant to the amendments, firms are required to record time in milliseconds (*i.e.*, HH:MM:SS:mmm) when reporting trades to FINRA or order information to OATS if the firm's systems capture milliseconds. If the firms systems do not capture milliseconds, then they are permitted to continue to report time in seconds. As technology improves, FINRA expects to see an increasing number of firms capture time in milliseconds, and make submissions accordingly.

5. Current FINRA rules require that if a trade is cancelled or reversed, but was previously reported to FINRA, then firms must report the cancellation or reversal to the exact FINRA facility to which the trade was originally reported within the specified time frames. The amendments require firms to identify the original trade by including the control number generated by the FINRA facility, as well as the date for the original trade report.

6. Also pursuant to the amendments, firms must report trades executed on non-business days and trades reported more than 365 days after a trade date (T+365) to a FINRA facility. These trades are assessed regulatory fees under Section 3 of Schedule A to the FINRA By-Laws (Section 3) and are not submitted to clearing by the FINRA facility or disseminated.

7. Firms can effectuate a "step-out" by submitting a clearing-only report to a FINRA facility. In every step-out, one firm is stepping out of (or transferring) the position while the other firm is stepping into (or receiving) the position. Pursuant to the amendments, where both sides are submitting a clearing-only report to effectuate a step-out, the firm transferring out of the position is required to report a step-out, and the firm receiving the position is required to report a step-in.

8. When using the trade acceptance and comparison functionality of a FINRA facility, the reporting party reports

the trade and the contra party subsequently either accepts or declines the trade. The amendments clarify that rather than being purged from the system at the end of trade date processing, trades that have been declined by the contra party are carried over and remain available for cancellation or correction by the reporting party or subsequent acceptance by the contra party.

9. The OATS amendments were implemented April 7, 2014, and the ORF amendments were implemented November 17, 2014. The implementation date for the requirement relating to reporting in milliseconds to the ADF and TRFs was November 10, 2014. The implementation date for the remainder of the ADF and TRF amendments was July 13, 2015.

10. On October 8, 2015, FINRA announced the SEC's approval of its proposal to amend Rule 6110 (Trading Otherwise than on an Exchange) and Rule 6610, expanding the transparency initiative for OTC equity securities. Previously, each member operating an ATS reported its weekly volume, by security, to FINRA. FINRA makes information regarding the reported volume and trade count available to the public on its website. The amendments make the remaining OTC equity ("non-ATS") volume available to the public via the FINRA website.

11. In Regulatory Notice 15-51, published in December 2015, FINRA announced a new category of trade submissions. As of February 2016, firms may submit "clearing-only, non-regulatory" reports for OTC transactions in equity securities previously reported through a FINRA facility. These reports are submitted only to facilitate clearing; they are not used to disseminate information or to satisfy non-tape, regulatory reporting requirements.

12. On January 8, 2016, FINRA filed a proposed rule change with the SEC relating to ATS volume and trading information. FINRA proposed the following:

    a. deleting Rule 4552, which requires each ATS to report weekly volume information and number of trades regarding equity securities transactions within the ATS;

    b. amending Rules 6110 and 6610, seeking to publish on FINRA's website monthly aggregated ATS statistics on block trading across all NMS stocks, which would capture at least one month of trading and be published one month or later following the end of the month for which information was compiled; and

c. amending Rules 6183 and 6625 to require ATSs seeking a reporting exemption to provide FINRA with a link to a website displaying their weekly equity volume information in a similar format to that used by FINRA.

I. TRACE Updates

1. In Regulatory Notice 14-34, published in August 2014, FINRA announced that the SEC had approved amendments to the Trade Reporting and Compliance Engine (TRACE) rules and dissemination protocols. The amendments call for dissemination of transactions in an additional group of asset-backed securities, and reduce the time frame for reporting such transactions, other than Fixed or List Price and Takedown Transactions. Rule 144A transactions will also be disseminated. The amendments became effective on June 1, 2015.

2. In Regulatory Notice 14-53, FINRA reminded ATSs and ATS subscribers of their TRACE trade reporting obligations for TRACE-eligible securities. Pursuant to FINRA Rule 6730, each member firm that is a “party to a transaction” in a TRACE-eligible security is obligated to report the transaction within the specified period of time. As a party to a transaction, an ATS is included in the TRACE trade reporting obligations.

3. In February 2015, FINRA published Regulatory Notice 15-04, seeking comments on a proposal that would require dissemination of TRACE data for collateralized mortgage obligations, commercial mortgage-backed securities and collateralized debt obligations. The proposal also seeks to reduce the reporting time frame for these products to 45 minutes, then 15 minutes after nine months. The comment period expired April 10, 2015. FINRA received five comment letters in response to the notice.

4. In May 2015, FINRA published Regulatory Notice 15-14, which announced that the SEC had approved an amendment to FINRA Rule 6730 (Transaction Reporting). The amendment requires that (i) firms use a new contra-

party type to identify transactions with non-member affiliates in TRACE trade reports and (ii) firms use certain identifiers for trades that, in FINRA's view, would not provide investors with useful pricing, valuation or risk evaluation information. In particular, FINRA requires firms to use identifiers for trades with non-member affiliates that occur on the same day and at the same price as a trade between the firm and another contra-party in the same security. The amendment became effective on November 2, 2015.

5. On June 1, 2015, FINRA announced that investors would have access to information, through TRACE, about transactions in asset-backed securities, including those transactions effected pursuant to Securities Act Rule 144A. The transaction information distributed includes the CUSIP, time of trade, price and volume.

6. On June 23, 2015, FINRA published Regulatory Notice 15-24 requesting comments on a proposal to reduce the delay period for certain "historic" TRACE data sets to six months from 18 months. The comment period expired on August 24, 2015 and FINRA received four comment letters in response to the notice.

7. In July 2015, FINRA published Regulatory Notice 15-26 seeking comment on a proposal to create a new academic TRACE product. The product would only be available to higher education institutions for academic research and would include masked MPIDs. The comment period expired September 14, 2015. FINRA received three comment letters in response to the notice.

8. On September 28, 2015, FINRA filed SR-FINRA-2015-037 with the SEC, proposing to extend a TRACE pilot program until October 27, 2017. The pilot program exempts members from reporting requirements for transactions in TRACE-eligible securities executed on a facility of NYSE that are reported to NYSE and released publicly. Notice was published in the Federal Register on October 16, 2015, soliciting comments on the proposal.

9. On October 27, 2015, FINRA published Regulatory Notice 15-41, announcing SEC approval of amendments to Rule 6730. The amendments require firms to report transactions in TRACE-eligible securities "as soon as practicable" following execution. The amendments became effective on November 30, 2015.

10. In Regulatory Notice 15-47, published in November 2015, FINRA announced that the SEC approved amendments to the TRACE rules to require an indicator when a TRACE report does not reflect a commission or mark-up/mark-down. The amendments will be implemented on May 23, 2016.

11. On December 8, 2015, FINRA filed SR-FINRA-2015-055 to propose a rule change that would provide FINRA with the authority to exempt trades on ATSs from Rule 6730 trade reporting obligations when those trades do not otherwise fall within the Rule 6731 exemption. Notice was published in the Federal Register on December 23, 2015, soliciting comments.

J. Background Checks on Registration Applicants

1. On April 24, 2014, FINRA announced that its Board of Governors approved amendments to FINRA Rule 3110 (Supervision) that would expand the obligations of firms to check the background of applicants for registration to verify the accuracy and completeness of the applicant's Uniform Application for Securities Industry Registration or Transfer, or Form U4.

2. In Regulatory Notice 15-05, FINRA announced that the SEC approved two rule changes relating to background checks on registration applicants.

   a. The SEC approved FINRA's proposal to adopt FINRA Rule 3110(e), which is based on NASD Rule 3010(e) and NYSE Rule 345.11. FINRA Rule 3110(e) includes new provisions that require a firm's written procedures to specify its process for verifying information submitted in Form U4. In addition, the firm must complete these verifications within 30 days after the Form U4 is filed. FINRA Rule 3110(e) became effective on July 1, 2015.

   b. The SEC also approved FINRA's proposal to adopt FINRA Rule 3110.15. Rule 3110.15 establishes a program to issue refunds of Late Disclosure Fees to members in certain instances. It became effective, retroactively, on April 24, 2014 and expired on December 1, 2015.

K. Customer Disputes and Expungement

1. The FINRA Board of Governors, in its February 2014 meeting, authorized FINRA to file with the SEC proposed FINRA Rule 2081 (Prohibited Conditions Relating to Expungement of Customer Dispute Information).

2. The proposal would have prohibited firms and associated persons from "conditioning, or seeking to condition, settlement of a customer dispute on the customer's agreement that he or she not oppose the member's or associated person's request to expunge the customer dispute from the FINRA CRD system."

3. On July 23, 2014, FINRA announced that the SEC approved a new rule prohibiting the conditioning of a settlement of a customer dispute on an agreement to expunge such information from the CRD system.

4. In September 2015, the Board authorized FINRA to file proposed amendments to Rules 12805 and 13805 of the Codes of Arbitration with the SEC. These amendments would codify best practices, as explained in the Expanded Expungement Guidance issued in 2013 and updated in September 2015.

L. Pay-to-Play Rule

1. In July 2010, the SEC adopted Advisers Act Rule 206(4)-5, which addresses pay-to-play practices by investment advisers. Under the SEC Pay-to-Play Rule, an investment adviser is prohibited from providing advisory services for compensation to a government entity for two years after the adviser (or its covered associates) makes a contribution to an official of the government entity, unless there is an applicable exception or exemption.

2. The SEC Pay-to-Play Rule also prohibits an investment adviser from providing or agreeing to provide payment to any member firm to solicit a government entity for investment advisory services on behalf of the investment adviser, unless the member firm is subject to a FINRA pay-to-play rule.

3. In Regulatory Notice 14-50, published in November 2014, FINRA proposed a pay-to-play rule, Rule 2390, modeled on the SEC Pay-to-Play Rule that would impose substantially equivalent or more stringent restrictions on member firms engaging in distribution or solicitation activities than the SEC Pay-to-Play Rule imposes on investment advisers. FINRA

also proposed rules that would impose recordkeeping and disclosure requirements on member firms in connection with political contributions.

4. Specifically, FINRA sought comment on three proposed new rules: Rule 2271 (Disclosure Requirement for Government Distribution and Solicitation Activities); Rule 2390 (Engaging in Distribution and Solicitation Activities with Government Entities); and Rule 4580 (Books and Records Requirements for Government Distribution and Solicitation Activities).

5. On December 16, 2015, FINRA filed a proposed rule change to adopt Rule 2030 and Rule 4580 with the SEC, establishing "Pay-to-Play" and related rules.

M. Securities Trader Registration and Qualification Examination

1. In Regulatory Notice 15-45, published in November 2015, FINRA announced that the SEC had approved a registration category and qualification examination requirement for Securities Traders and Securities Trader Principals. The Securities Trader registration category and examination (Series 57) replaced the Equity Trader registration category and examination (Series 55). The Securities Trader Principal registration category was added for principals that supervise securities trading activities. Those wishing to register as Securities Trader Principal must register as a Securities Trader and pass the General Securities Principal examination (Series 24).

2. Candidates for the Series 57 examination were able to schedule and take the examination as of January 4, 2016. FINRA published a content outline to familiarize candidates with the subject matter tested.

N. Derivatives/Off-Balance Sheet Items

1. On December 31, 2015, FINRA filed SR-FINRA-2015-059 with the SEC to propose a rule change expanding the application of the Derivatives and Other Off-Balance Sheet Items Schedule ("OBS") to certain non-carrying/non-clearing firms that have large amounts of off-balance sheet obligations.

2. Firms that carry customer transactions, self-clear, or clear transactions for others must file the OBS, as a supplement to FOCUS reports, within 22 business days of each quarter's end, unless the firm falls into the de minimis exception set

forth in the OBS instructions. The proposed rule would expand this requirement to firms that do not carry customer accounts and do not clear transactions, if those firms have a minimum dollar net capital requirement of at least $100,000 and at least $10 million in reportable items.

O. Payments to Unregistered Persons

1. In March 2015, FINRA published Regulatory Notice 15-07, announcing the SEC's approval of changes to Rule 2040 (Payments to Unregistered Persons). Rule 2040 governs transaction-based payments to unregistered persons by firms.

    a. Section (a) of Rule 2040 prohibits payments by firms to persons not registered, but required to be registered under federal securities laws, as broker-dealers. Supplementary Material .01 provides guidance to firms as to whether unregistered persons may be required to be registered under federal securities laws.

    b. Section (b) of Rule 2040 provides guidance on continuing payments to retiring registered representatives. Payments may be made to retiring registered representative if (i) the firm and representative entered into a good faith, bona fide contract that prohibits the representative from soliciting new business and (ii) the arrangement complied with federal securities laws and other applicable rules and regulations.

    c. Section (c) of Rule 2040 allows a firm to pay transaction-related payments to a non-registered foreign finder if the finder's only involvement in the transaction is its initial referral of non-US customers to the firm and the firm complies with conditions set forth in the rule.

2. Rule 2040 became effective on August 24, 2015.

P. OTC Equity Trading and Reporting in the Event of Systems Issues

1. On January 20, 2016, FINRA released a Trade Reporting Notice, reminding firms to establish and enforce written policies and procedures that address the firm's response to a FINRA facility systems issue or issues with its own or a vendor's system.

2. FINRA reminded firms that they must report OTC transactions in equity securities "as soon as practicable," but no later than 10 seconds after execution. If a FINRA facility experiences systems issues, firms must connect and report to a second FINRA facility, route orders to an exchange or another FINRA firm, or stop OTC trading. In cases where a FINRA facility is operating normally but a systems issue affects a limited number of firms, it may be reasonable for the firm to continue to execute and report OTC trades to the FINRA facility. Finally, FINRA issued a warning that repeated failure of a firm's or vendor's system is not a reasonable justification for consistent late reporting.

Q. Mark-Up Rule and Exempted Securities

1. In January 2016, FINRA published Regulatory Notice 16-03, announcing the SEC's approval of changes to Rule 0150. These changes codify the application of rules governing mark-ups and commissions to transactions in exempted government securities. FINRA historically viewed Rule 2010 as supporting an action for excessive mark-ups in transactions in exempt securities; Rule 0150 explicitly applies FINRA's mark-up rules to these types of transactions, including those transactions relating to U.S. Treasury securities.

R. BrokerCheck

1. In November 2015, FINRA released Regulatory Notice 15-49, announcing the SEC's approval of changes to FINRA's BrokerCheck Disclosure rule (Rule 8312). These changes reduce the waiting period from 15 days to three business days for the release of certain information reported on the Uniform Termination Notice for Securities Industry Registration (Form U5) through BrokerCheck. FINRA stated that a shorter delay is more reasonable, in that it allows investors to more quickly access disclosure information reported on Form U5 while still providing brokers the opportunity to comment on the disclosure. The rule became effective on December 12, 2015.

2. In December 2015, FINRA released Regulatory Notice 15-50, announcing the SEC's approval of amendments to Rule 2210 (Communications with the Public). The changes require firms to display a "readily apparent reference and hyperlink" to BrokerCheck on their websites. Specifically, the reference and hyperlink must appear on the initial

website viewed by retail investors and any website that includes a professional profile of any registered person who conducts business with retail investors. The rule does not require a firm to display a reference and hyperlink to BrokerCheck on communications to retail investors via a third party website, email or text message. The rule amendments will become effective on June 6, 2016.

S. Comprehensive Automated Risk Data System (CARDS)

1. CARDS, as proposed in Regulatory Notice 13-42, would allow FINRA to collect, "on a standardized, automated and regular basis, account information, as well as account activity and security identification information that a firm maintains as part of its books and records." FINRA noted that this information would normally be collected during on-site examinations.

2. FINRA would use automated systems to analyze the data for certain "red flags" of sales practice and business misconduct.

3. FINRA, in response to privacy issues raised by commenters, provided an update to Regulatory Notice 13-42 on March 4, 2014, noting that the CARDS proposal would no longer require the submission of information that would identify individual account owners.

4. On September 30, 2014, FINRA issued Regulatory Notice 14-37 requesting comment on a proposed rule to implement CARDS. The comment period expired on December 1, 2014. Regulatory Notice 14-37 contains an Interim Economic Impact Assessment, which discusses the anticipated costs and benefits of the proposed rule. FINRA staff assessed information about the costs, benefits and other economic impacts of CARDS.

5. The rule proposal would be implemented in two phases. The first would require carrying or clearing firms to periodically submit specific information that is part of the firms' books and records relating to securities accounts. The second phase would require fully-disclosed introducing firms to submit specified account profile-related data elements.

6. The rule proposal would also exclude the collection of personally identifiable information (PII) for customers,

including account name, account address and Social Security number.

7. In 2015 FINRA indicated it would not move ahead with the present form of the proposal (or an amended version) until the concerns raised in the comments have been addressed.

II. Other Regulatory Matters of Interest

A. FINRA's Retrospective Rule Review Reports

1. In 2014, FINRA launched its Retrospective Rule Review process to determine whether rules are meeting their intended objectives by reasonably efficient means, and whether they are relevant to the current market conditions and carefully tailored to protect investors.

2. In March 2015, FINRA announced that it had issued Regulatory Notice 15-10, requesting comment on the effectiveness and efficiency of its Membership Application rules. The comment period expired May 14, 2015. FINRA received four comment letters in response to the notice.

B. Best Execution

1. In November 2015, FINRA released Regulatory Notice 15-46 to remind firms of their best execution obligations in receiving, handling, routing or executing customer orders in securities and obligations to regularly, rigorously examine execution quality obtained from different markets trading a security.

2. Broker-dealers have a duty of best execution, codified by Rule 5310. Rule 5310 requires broker-dealers to "use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions." Among the factors considered when analyzing "reasonable diligence" are the size and type of transaction, character of the market, markets checked, accessibility of the quotation and terms and condition of the initial order. Firms cannot transfer best execution obligations to another person.

3. FINRA reminded firms that they must have procedures in place to "regularly and rigorously" review execution quality, while noting that such review may not satisfy obligations

under the best execution duty when routing or internally executing large orders.

4. FINRA recommended that firms carefully evaluate their receipt of payment for order flow and these practices' impact on execution quality. Additionally, FINRA addressed directed orders for a particular market; in these cases, a firm is not obligated to make a best execution determination beyond the specific instruction from the customer. Finally, FINRA addressed additional considerations for best execution practices when applied specifically to fixed income securities, noting that whether a firm has met its best execution obligations will depend on the character of the market for the security.

C. Revised Sanction Guidelines

1. In May 2015, FINRA announced significant revisions to its Sanction Guidelines, including amending the overarching principles that apply to sanction determinations and revising the guidelines to call for increased sanctions for fraud and unsuitable recommendations. The revised guidelines advise FINRA adjudicators to strongly consider bars for individuals or expulsion for firms in cases involving fraud. For suitability violations, the range of the suspension has increased for the high end from one year to two years, and adjudicators are advised to strongly consider bars if aggravating factors outweigh mitigating ones. The amendments also emphasize a policy of imposing progressively escalating sanctions where there are patterns of similar misconduct or evidence of a reckless disregard for regulatory requirements, investor protection, or market integrity.

III. FINRA's 2016 Regulatory and Examination Priorities[2]

FINRA rang in the New Year with the release on January 5 of its annual Regulatory and Examination Priorities Letter. The 2016 Letter identifies supervision, liquidity, and firm culture as broad themes for 2016. As in previous years, FINRA focused on areas of risk affecting investor interests and market stability.

The below discussion highlights potential new areas of concern for firms as well as identifying topics that have fallen down (or off) the priority list

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2 The information in this section is contained in a Law Flash authored by Timothy P. Burke, Merri Jo Gillette and Ben A. Indek of Morgan, Lewis & Bockius LLP. It was published on January 6, 2016.

since 2015—to help guide firms' assessment of risk management policies in order to align with FINRA's priorities in the new year.

A. New Priorities for 2016

1. Firm Culture

Expanding on last year's "tone from the top" message, the 2016 Letter announces that FINRA will formalize its assessment of a firm's culture when reviewing how its executives, supervisors, and employees conduct business. We expect this to mean a top-to-bottom focus on how firms implement their policies and procedures. Indicators FINRA will consider when assessing a firm's culture include management of conflicts of interest, adequacy of compliance functions, and responses to breaches of firm policies.

2. Conflicts of Interest

Underscoring FINRA's focus on firm culture, ethics, and supervision, the 2016 Letter emphasizes specific areas that could create conflicts of interest, including compensation incentive structures, investment banking and research business conflicts, information leakage inside and outside a firm, and position valuation. FINRA will review whether research analysts are inappropriately involved in banking activities, whether information is being inappropriately leaked between different areas of a firm's trading activities, and the many conflicts that can arise when traders provide valuations for the illiquid (level 3) positions they establish. The 2016 Letter also notes concern with potentially inadequate review by firms of employees' outside business activities.

3. Supervision of Technology

FINRA will review firms' approaches to cybersecurity risk management and consider the ability of firms to protect the confidentiality and integrity of sensitive customer information, as well as high-frequency trading firms' ability to protect systems from unauthorized access. FINRA notes that firms retain the responsibility to supervise certain activities outsourced to third-party providers.

4. Anti-Money Laundering Controls

FINRA addresses anti-money laundering (AML) controls as a supervisory issue. The 2016 Letter states that FINRA expects firms to routinely test their AML compliance systems. FINRA will focus on high-risk accounts and activity and will review documentation of any decision to exclude certain customer transactions from surveillance.

B. Continued Focus

The 2016 Letter also lists a host of perennial priorities that appear year-after-year. This year's list includes the following:

1. Seniors and Vulnerable Investors

FINRA has again identified this class of investor as an increased priority. Of particular note, the 2016 Letter highlights instances of third-party fraud perpetrated upon seniors by bad actors in positions of trust who hold powers of attorney or other means of controlling assets. FINRA also previewed that it will look closely at the sale of high commission products to senior or vulnerable investors.

2. Suitability and Concentration

FINRA indicated that it would continue its focus on complex products, speculative or longer-duration interest-rate sensitive products, and alternative investments. FINRA's 2016 Letter notes that while "many firms have established robust systems" to support recommendations of these products, "others have not." Regardless, firms should expect continued scrutiny regarding the recommendation of these products.

3. Fixed-Income Orders

Handling of fixed-income orders seem likely to remain a priority in 2016, given the attention in FINRA's 2016 Letter, as well as guidance in its 2015 regulatory notice "Guidance on Best Execution Obligations in Equity, Options and Fixed Income Markets." In the 2016 Letter, FINRA explains that it will augment its best execution surveillance using spread-based surveillance patterns. This focus coincides with the MSRB's focus on best execution in the fixed-income markets, outlined in its new rule scheduled to take effect on March 21, 2016.

4. Market Access

FINRA also seems likely to continue its focus on market access, and will begin publishing monthly "report cards" focused on layering and spoofing. These reports may be useful for firms to assess their own surveillance systems and enhance their policies, practice, and protocols as appropriate.

5. Sales Charge Discounts and Waivers

Another recurring priority (and the subject of several 2015 settlements) is FINRA's continued concern with firms that fail to provide appropriate volume discounts (breakpoints) or sales charge waivers for products such as mutual funds, Unit Investment Trusts (UITs), non-traded Real Estate Investment Trusts (REITs), and Business Development Companies (BDCs).

C. Diminished Focus in 2016?

Of arguably equal use to firms may be areas that have "dropped off" the letter since last year. None of the following areas in FINRA's 2015 Regulatory and Examination Priorities Letter (2015 Letter) were included in the 2016 Letter:

1. IRA Rollovers and Other Wealth Events

In 2015, FINRA focused on fair and balanced communication related to wealth events, such as IRA rollovers. The 2015 Letter emphasized concern with adequate communication of fees, as well as policies to ensure that no recommendation would occur if a broker-dealer did not intend for its registered representative to recommend securities transactions as a result of an IRA rollover.

2. Municipal Adviser Registration

The 2015 Letter expressed concern about failure to register as a municipal adviser, noting that the SEC's municipal advisor registration rules became effective July 1, 2014.

3. Reporting of Disclosable Information

The 2015 Letter focused on adequate and timely disclosure of information, primarily information derived from U4 and U5 registration filings. FINRA indicated that this focus would include a review of all registered persons to determine whether there were any reporting failures.

D. FINRA's complete list of its regulatory and examination priorities for 2016 is as follows:

1. Broad Issues

   a. Culture, Conflicts of Interest and Ethics

   b. Supervision, Risk Management and Controls

      i. Management of Conflicts of Interest

         a) Incentive Structures

         b) Investment Banking and Research Business Lines

         c) Information Leakage

         d) Position Valuation

      ii. Technology

         a) Cybersecurity

         b) Technology Management

         c) Data Quality and Governance

      iii. Outsourcing

      iv. AML Controls

         a) Suspicious Activity Monitoring

         b) Microcap Securities

      v. Liquidity

         a) Firm Funding

2. Other Areas of Focus in 2016

   a. Sales Practice

      i. Suitability and Concentration

      ii. Seniors and Vulnerable Investors

      iii. Sales Charge Discounts and Waivers

iv. 529 College Savings Plans

v. Private Placements, the JOBS Act and Public Offerings

a) Private Placements

b) Public Offerings

c) Non-Traded REITs and Direct Participation Programs (DPPs)

d) Excessive Charges to Customers in New Bond Sales

vi. Outside Business Activities (OBA)

b. Financial and Operational Controls

i. Market-Maker Net Capital Exemptions

ii. Exchange-Traded Funds (ETFs)

iii. Fixed Income Prime Brokerage

iv. Internal Audit

v. Client Onboarding

vi. Transmittal of Customer Funds

c. Market Integrity

i. Vendor Display Rule

ii. Market Access

iii. Fixed Income

iv. Regulation SHO

v. Cross-Market and Cross-Product Manipulation

vi. Audit Trail Integrity