



**2018 FINRA and SEC Examination Priorities**  
Summary and Comparison  
February 2018

# Overlapping examination priorities for 2018

A review of the 2018 Securities and Exchange Commission's (SEC) Office of Compliance Inspections and Examinations (OCIE) priorities letter and the Financial Industry Regulatory Authority's (FINRA) annual examination priorities letter shows five overlapping priorities

## FINRA exam priorities

### New Priorities

- Fraud
- Business continuity planning
- Customer protection and verification of assets and liabilities
- Technology governance
- Short sales
- Initial coin offerings (ICOs) and cryptocurrencies
- Use of margin
- Securities backed lines of credit
- Fixed income data integrity
- Options
- Alternative trading system surveillance
- Report cards
- New rules<sup>1</sup>

### Recurring Priorities

- High-risk firms and brokers
- Cybersecurity
- Anti-money laundering (AML)
- Liquidity risk
- Suitability
- Manipulation
- Best execution
- Regulation SHO
- Market access

## Overlapping priorities

### Cybersecurity

Examinations will focus on governance and risk assessments, access rights and controls, data loss prevention, vendor management, training, and incident response

### AML

Firms must appropriately adapt their AML programs to address regulatory obligations, including the new customer due diligence requirement

### Cryptocurrencies and ICOs

In cases where these products are securities, they will be examined for regulatory compliance



### Best execution

FINRA is expanding its fixed income best execution surveillance program to assess the degree to which firms provide price improvement when routing customer orders for execution

### Senior investors

Examinations will focus on, investment recommendations, sales of variable insurance products, and sales and management of target date funds

## SEC exam priorities

### New Priorities

- Disclosure of the costs of investing
- Mutual funds
- Fixed income order execution
- Cryptocurrency, ICOs, secondary market trading, blockchain

### Recurring Priorities

- Electronic investment advice
- Wrap fee programs
- Never-before-examined investment advisers
- Senior investors and retirement accounts and products
- Exchange-traded funds
- Municipal advisors and underwriters
- Clearing agencies
- National securities exchanges
- Transfer agents
- Regulation Systems Compliance and Integrity (SCI) entities
- FINRA and Municipal Securities Rulemaking Board (MSRB)
- Cybersecurity
- AML

<sup>1</sup> FINRA highlighted significant new rules that are scheduled to become applicable in 2018. FINRA further noted that it may discuss with certain firms the implementation steps that are being taken to meet new regulatory requirements under these rules.

# Appendix

Appendix A: Summary of 2018 FINRA examination priorities

Appendix B: Summary of 2018 SEC examination priorities

# Appendix A: 2018 FINRA examination priorities (1 of 7)

Topic	Background	Focus
<b>Fraud</b>		
Fraud	Having made hundreds of referrals in 2017 to the SEC for potential insider trading and other activities that may indicate fraud, FINRA continues to focus on fraud in 2018	Focus will include insider trading, microcap pump-and-dump schemes, issuer fraud, and Ponzi-type schemes. A particular focus will be on schemes directed to senior investors
<b>High-risk firms and brokers</b>		
High-risk firms and brokers	FINRA has allocated significant resources to monitoring high-risk brokers and will continue to focus on identifying and examining brokers that may pose the highest risk to investors	Focus will include reviews of suitability, know-your-customer requirements, outside business activities, and private securities transactions, along with an evaluation of hiring firm controls, firms' remote supervision arrangements; focus will also be on the supervision of point-of-sale activities for high risk brokers

# Appendix A: 2018 FINRA examination priorities (2 of 7)

Topic	Background	Focus
<b>Operational and financial risks (1 of 2)</b>		
Business continuity planning	In response to natural disasters in 2017, FINRA plans to assess firms' abilities to maintain their business in such events	FINRA will review firms' business continuity plans with a particular focus on the implementation of their plans (e.g., circumstances used to activate plans, coordination with vendors)
Customer protection and verification of assets and liabilities	The protection of customer assets and the accuracy of firms' financial data are priorities in FINRA's examinations. FINRA will examine the accuracy of firms' net capital and reserve computations under Securities Exchange Act (SEA) Rules 15c3-1 and 15c3-3	In examining the accuracy of firms' net capital and reserve computations under SEA Rules 15c3-1 and 15c3-3, there will be a particular focus on firms' records, processes for verifying customers' financial records and the controls in place to comply with 15c3-3
Technology governance	As a result of system breakdowns and their impact to customers, FINRA will review firms' information and technology change management policies and procedures	Focus will be on firms maintaining strong controls to prevent implementations of technologies that are incomplete and/or untested
Cybersecurity	FINRA continues to see cybersecurity as a risk and a priority for 2018	Focus of FINRA's review will be on the effectiveness of firms' cybersecurity programs to protect sensitive information (e.g., personally identifiable information) from internal and external threats

# Appendix A: 2018 FINRA examination priorities (3 of 7)

Topic	Background	Focus
<b>Operational and financial risks (2 of 2)</b>		
AML	FINRA has identified concerns related to the adequacy of firms' policies and procedures to detect and report suspicious transactions, their resources for monitoring AML, and their independent testing activities required under FINRA Rule 3310(c)	Focus will be on review of Examination Findings Report by firms to understand FINRA's areas of concern and observations on effective practices related to AML. Firms will need to ensure that their AML surveillance programs cover accounts used in connection with securities-backed lines of credit (SBLOCs)
Liquidity Risk	FINRA will continue to focus on liquidity risk while sharing leading practices from firms	FINRA's focus will be on firms' liquidity management plans. FINRA indicates that firms should review Regulatory Notice to Members 15-33 for effective practices that may be useful
Short Sales	In response to instances such as those where securities are borrowed into a conduit account and then loaned to a house account at a significant markup, FINRA will examine firms' policies and procedures for establishing and monitoring the rates charged to customers for short sales	FINRA's focus will be on how firms calculate rates for short sales and the consistency of those practices against formal procedures

# Appendix A: 2018 FINRA examination priorities (4 of 7)

Topic	Background	Focus
<b>Sales practice risks</b>		
Suitability	To address the suitability risks that investors may encounter as a result of the increasingly complex products available in the market, FINRA will continue to focus on firms' suitability practices	FINRA's will focus on firms' ability to identify the risks associated with a product and include those risks in their product training so that registered representatives can appropriately evaluate them prior to recommending the product to a customer. For employer-sponsored retirement plans, FINRA will focus on the suitability of firms' and registered representatives' recommendations made to plan participants
ICOs	FINRA will monitor developments in the area of digital assets and ICOs, including the role of firms and their registered representatives in effecting transactions	Particularly for those transactions that involve securities, FINRA may review firms' practices to comply with relevant federal securities laws and regulations and FINRA rules
Use of Margin	In response to observing situations where customers are solicited into entering into margin transactions, FINRA will assess firms' disclosure and supervision practices	FINRA's focus will be on whether firms and registered representatives disclose the risk of margin loans and whether controls are in place to prevent excessive margin trading
Securities Backed Lines of Credit (SBLOCs)	SBLOCs, having gained popularity in recent years, will be a focus of FINRA's review in 2018	FINRA's focus will be on firms' practices to ensure customers are informed of the risks and tax implications of SBLOCs

# Appendix A: 2018 FINRA examination priorities (5 of 7)

Topic	Background	Focus
<b>Market integrity (1 of 3)</b>		
Manipulation	Protecting market integrity is a top priority for FINRA. FINRA regularly identifies new scenarios that threaten market integrity and expects firms keep their surveillance programs up to date	Examples of focus areas include identifying aggressive trading around the open or close of markets through the use of machine learning and surveilling participants involved in Cross Market Layering
Best execution	Best execution remains as an important investor protection requirement and continues to be a priority for FINRA in 2018	FINRA will review how firms manage the conflicts of interest that exist between their duty of best execution and their own financial interests. For fixed income securities, review of execution quality and fair pricing will be expanded
Regulation SHO	FINRA will increase focus on evaluating firms' compliance with Rule 201 of Regulation SHO	Firms need to ensure they have developed policies and procedures to prevent the execution or display of a short sale order at a price that is less than or equal to the national best bid when a Short Sale Circuit Breaker is in effect for a National Market System (NMS) security. Firms relying on exemption 201 need to ensure they qualify for exemption
Fixed income data integrity	As Treasury securities will be reported to the Trade Reporting and Compliance Engine (TRACE) in July 2017, FINRA has developed a suite of surveillance patterns to monitor the accuracy of firms' transaction reporting in Treasury securities	Focus would be on expanding examinations to include Treasury securities' reviews for complete, timely and accurate reporting of TRACE-eligible securities

# Appendix A: 2018 FINRA examination priorities (6 of 7)

Topic	Background	Focus
<b>Market integrity (2 of 3)</b>		
Options	In 2017, FINRA developed a surveillance pattern to detect potential front running in correlated options products and in 2018, will continue to treat this as a priority	FINRA will focus on detecting scenarios involving front running, "marking the close" activities, and violations related to SEA Rule 14e-4, which governs partial tender offers and requires that participants tender no greater than their "net long position"
Market access	FINRA will continue to review broker-dealers' compliance with SEA Rule 15c3-5 (the Market Access Rule), which requires that pre-trade financial controls are in place	Firms are expected to maintain reasonable documentation to support financial limits and conduct periodic reviews to assess the reasonableness of those thresholds
Alternative trading system surveillance	FINRA requires that firms with alternative trading systems maintain a supervisory infrastructure that complies with applicable regulations	The focus of FINRA's review will be on the supervisory infrastructure of alternative trading systems with respect to detecting manipulative trading activities

# Appendix A: 2018 FINRA examination priorities (7 of 7)

Topic	Background	Focus
<b>Market integrity (3 of 3)</b>		
Report cards	In 2018, FINRA will launch several new report cards to assist firms with their compliance efforts	<p>The <b>Auto Execution Manipulation Report Card</b> will highlight and assist firms with their supervision efforts to identify instances in which a market participant uses non-bona fide orders to move the National Best Bid or Offer (NBBO)</p> <p>The <b>Alternative Trading System Cross Manipulation Report Card</b> will identify instances of potential manipulation of the NBBO</p> <p>The <b>Fixed Income Mark-up Report Card</b> will provide key markup metrics to and the industry, which firms will be able to display based on certain criteria such as investment rating, product (e.g., corporate or agency) and length of time to maturity</p>

# Appendix B: 2018 SEC examination priorities (1 of 9)

Topic	Background	Focus
<b>Retail investors (1 of 4)</b>		
Disclosure of the costs of investing	SEC believes that given investors pay fees and expenses, they are entitled to disclosures of fees, expenses, and other important information, such as conflicts of interest	SEC's focus will be on firms' calculation of fees and expenses, policies and procedures and any practices that may increase the risk of causing investors to pay undisclosed fees or expenses
Electronic investment advice	SEC will examine investment advisers and broker-dealers that offer investment advice through digital platforms such as "robo-advisers"	SEC's focus will include firms' compliance programs, algorithms for generating recommendations, and investor data protection
Wrap fee programs	SEC will continue to examine registered investment advisers and broker-dealers associated with wrap fee programs. Investment advisers will be reviewed to ascertain whether they are acting in a manner consistent with their fiduciary duty and whether they are meeting their contractual obligations to clients	Focus areas will be whether (i) recommendations are reasonable, (ii) conflicts of interests are disclosed, and (iii) best execution is obtained and fees are disclosed when executing trades through another broker-dealer

## Appendix B: 2018 SEC examination priorities (2 of 9)

Topic	Background	Focus
<b>Retail investors (2 of 4)</b>		
Never-before-examined investment advisers	SEC will continue with examination of newly registered investment advisers as well as or that have not been examined recently	Examination focus will be on investment advisers that have elevated risk profiles
Senior investors and retirement accounts and products	There will be review of how firms oversee their interactions with senior investors, including firms' ability to identify financial exploitation of senior investors	Focus will be on the internal controls developed to supervise representatives and their particularly sales practices. Focus will continue to be on investment advisers and brokers that offer products and services to retirement investors, including those in state and local government plans (e.g., 403(b) and 457 plans)

## Appendix B: 2018 SEC examination priorities (3 of 9)

Topic	Background	Focus
<b>Retail investors (3 of 4)</b>		
Mutual funds and exchange traded funds (ETFs)	SEC plans to focus on mutual funds and ETFs , both of which are key investment vehicles for retail investors	<p>Focus of mutual fund reviews will be on those that have poor liquidity, managed by advisers with limited experience, or are difficult to value during times of market stress</p> <p>Focus of ETF reviews will be on those that have limited secondary market trading or face the risk of being delisted from an exchange</p>
Municipal advisors and underwriters	SEC will continue to examine municipal underwriters for their compliance with MSRB and SEC rules. We will continue to examine municipal advisors to evaluate their compliance with registration, recordkeeping, and supervision requirements, particularly those municipal advisors that are not registered as broker-dealers	SEC will focus on municipal advisors' compliance with registration, recordkeeping, and supervision and compliance with professional qualification requirements, continuing education requirements, and core standards of conduct
Fixed income order execution	SEC believes that best execution is a key investor protection requirement in the fixed income secondary markets	Examinations will be conducted to assess whether broker-dealers have implemented best execution policies and procedures, that align with regulatory requirements, for both municipal bond and corporate bond transactions

## Appendix B: 2018 SEC examination priorities (4 of 9)

Topic	Background	Focus
<b>Retail investors (4 of 4)</b>		
Cryptocurrency, ICOs, secondary market trading, and blockchain	Given the increasing involvement of broker-dealers and advisers engaged in this market, SEC will continue to monitor the sale of these products, and focus examination efforts on those products that have been identified as securities	Areas of focus will include whether financial professionals maintain adequate controls and safeguards to protect these assets from theft and whether financial professionals are disclosing the risks associated with these investments to investors

## Appendix B: 2018 SEC examination priorities (5 of 9)

Topic	Background	Focus
<b>Compliance and risks in critical market infrastructure (1 of 2)</b>		
Clearing agencies	SEC will continue to conduct annual examinations of clearing agencies that the Financial Stability Oversight Council has designated as systemically important and for which the Commission is the supervisory agency	Examinations will focus on clearing agencies' compliance with the Commission's Standards for Covered Clearing Agencies and whether clearing agencies have taken corrective actions to resolve findings from prior examinations
National securities exchanges	Specific to NMS plans, OCIE, in coordination with the Division of Trading and Markets, will conduct examinations of the equities and options consolidated market	Focus will include the internal audits conducted by the exchanges, the fees paid under Exchange Act Section 31, and the governance and operation of certain National Market System plans
Transfer agents	SEC believes that efficient transfer agent operations are critical to secondary securities markets	SEC examinations will focus on transfers, recordkeeping, and the safeguarding of funds and securities. Candidates for examination will include transfer agents that serve as paying agents or that service microcap or crowdfunding issuers

## Appendix B: 2018 SEC examination priorities (6 of 9)

Topic	Background	Focus
<b>Compliance and risks in critical market infrastructure (2 of 2)</b>		
Regulation SCI entities	Regulation SCI, which was adopted by the Commission to strengthen the technology infrastructure of the <b>US</b> securities markets, will be an area of focus in 2018	SEC will continue to examine SCI entities to evaluate policies and procedures set up for the entities' systems' capacity and resiliency. Examinations will also assess entities' readiness and business continuity plan effectiveness, vendor risk management, particularly in cloud environments, and enterprise risk management

## Appendix B: 2018 SEC examination priorities (7 of 9)

Topic	Background	Focus
<b>FINRA and MSRB</b>		
FINRA	FINRA, a registered national securities association and a primary regulator of most SEC-registered broker-dealers, will be examined by SEC	SEC's examinations of FINRA will focus on FINRA's operations and regulatory programs and the quality of FINRA's examinations of broker-dealers and municipal advisors that are also registered as broker-dealers
MSRB	MSRB, which regulates the activities of broker-dealers that buy, sell, and underwrite municipal securities and also regulates municipal advisors, will be examined by SEC	SEC will examine the MSRB to evaluate the effectiveness of select operational and internal policies, procedures, and controls

## Appendix B: 2018 SEC examination priorities (8 of 9)

Topic	Background	Focus
<b>Cybersecurity</b>		
Cybersecurity	SEC will continue to prioritize cybersecurity in each of their examination programs in 2018	SEC examinations will continue to include a review of firms' governance and risk programs, access rights and controls, data loss prevention processes, vendor management programs, training, and incident response processes

## Appendix B: 2018 SEC examination priorities (9 of 9)

Topic	Background	Focus
<b>AML</b>		
AML	AML will continue to be an area of focus in 2018 by the SEC	The SEC will continue to focus on examining whether the entities being regulated are appropriately adapting their AML programs to address their obligations. Focus will also be on assessing whether these entities are appropriately filing suspicious activity reports



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