



## Risk Management Update April 2010

### FINRA 2010 EXAMINATION HIGHLIGHTS

#### Background

On March 1, 2010, the Financial Industry Regulatory Authority (“FINRA”) issued its annual letter highlighting the main points of interest for this year’s FINRA examinations. This information provides important guidance to member firms, particularly as they review their compliance internal controls throughout the year. The following article summarizes those developments evolving at FINRA and how this may impact your compliance programs. In addition, Core Compliance & Legal Services, Inc. (“CCLS”) also will highlight those examination priorities for member firms to be aware of in 2010 and beyond.

#### New Developments at FINRA

In addition to a host of new rules and amendments which took effect in 2010, there have been several new developments at FINRA. First, in response to a heightened need for more proactive and efficient securities fraud detection, in October 2009 FINRA created the Office of Fraud Detection and Market Intelligence. The principle function of this new Office is to provide a higher level of scrutiny and review of serious fraud allegations. The office is slated to provide a more centralized point of contact for FINRA in regard to fraud matters, and will serve to treat cases involving fraud in a more efficient manner by consolidating both subject matter expertise and investigatory tactics.

Second, in step with an ongoing commitment to providing the public with disclosure information, FINRA has substantially expanded its BrokerCheck® services. BrokerCheck® is a free service offered by FINRA designed to provide investors with background information on current and former FINRA-registered brokerage firms and representatives. Following the November 2009 expansion, investors now are able to learn about brokers who are no longer registered with FINRA, but have been subject to regulatory actions such as bars, suspensions and fines.

Third, as FINRA is a product of both NASD and NYSE guidelines and regulations, a process for consolidating and developing a rulebook was proposed to the Securities and Exchange Commission (SEC), which took effect on April 19, 2010. FINRA has provided conversion charts of the rules for firms to use as compliance references. To the extent that new FINRA rules impose different compliance requirements than the previous agencies, firms are charged with updating their compliance procedures promptly.<sup>1</sup>

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<sup>1</sup> The rule conversion charts may be viewed at: [www.finra.org/ruleconversionchart](http://www.finra.org/ruleconversionchart).

Lastly, FINRA has introduced eFOCUS™, which will serve as an upgraded database for firms to submit Financial and Operational Combined Uniform Single (FOCUS) reports to FINRA. By mid-2010, FINRA hopes to integrate all firms with the web portal.

### **2010 FINRA Examination Priorities**

In its release, FINRA provides guidance on the latest focus areas of its examination program.

#### *Fraud Detection*

In response to numerous cases of fraudulent conduct by firms, FINRA has expanded its fraud detection efforts through the creation of the centralized Office of Fraud Detection and Market Intelligence. FINRA examiners are proactively investigating instances of fraud and have received enhanced training on fraud detection procedures. Heavy on FINRA's watchlist include ponzi-schemes, stock manipulations, insider trading, misappropriation of assets and falsified statements.

To maintain compliance with FINRA standards, firms are required to maintain up-to-date supervisory systems designed to detect and prevent fraudulent activity by employees and other third parties. Other control systems that are recommended to firms include clearly identifying and segregating critical roles of personnel, thoroughly investigating any customer complaints or whistleblower tips and prompt notification to an authoritative body if a fraudulent act is uncovered.

#### *Protection of Customer Information and Cyber-Security*

With the increasing reliance on technology to support firm efficiencies, FINRA warns of the need for appropriate supervisory and monitoring techniques to ensure the safety of data. Risks include client account intrusions, cyber-attacks, data loss, privacy issues and risks involving third party service providers. Importantly, FINRA has highlighted the recent hacking of payment processors and the need to understand various vulnerabilities that lie within a firm's operating system.

Under Regulation S-P, firms are required to maintain policies and procedures in order to safeguard private information and records. These procedures should not only anticipate external threats to client information, but must also discuss protocols to mitigate threats posed by internal parties.<sup>2</sup>

#### *Anti-Money Laundering Compliance- a Continued FINRA Focus*

Continuing its focus on anti-money laundering, ("AML") efforts, in January 2010 FINRA adopted several new rules into their Consolidated Rulebook. One significant change brought on by the new AML rules requires firms, (typically smaller firms) to find an external individual to conduct AML compliance testing who in turn must meet independent testing requirements.<sup>3</sup>

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<sup>2</sup> [www.finra.org/customerprotection](http://www.finra.org/customerprotection), [www.finra.org/customerprotection/firmid](http://www.finra.org/customerprotection/firmid), [www.finra.org/customerprotection/checklist](http://www.finra.org/customerprotection/checklist)

<sup>3</sup> [www.finra.org/rulefiling/2009-039](http://www.finra.org/rulefiling/2009-039)

In mid-2009, FINRA took action against three firms for failing to detect, investigate and report suspicious transactions, resulting in fines in excess of \$1.25 Million. Consequently, expect FINRA examiners to closely review the firm's internal control systems for detecting fraudulent transactions as well as any customized monitoring systems used by the firm to identify AML associated risks.<sup>4</sup>

### *Emergency Preparedness and Business Continuity Planning*

In light of the financial disruptions businesses have witnessed over the past two years, succession planning is imperative. Moreover, external non-business factors such as the influenza A (H1N1) outbreak and other natural disasters require mandatory implementation and maintenance of Business Continuity Plans ("BCP") and Emergency Contact Information. FINRA is currently examining whether firms are testing and conducting risk analysis of their BCP, including the determination of vulnerability and likelihood of business disruptions.<sup>5</sup>

### **Conclusion**

FINRA continues to focus its examinations on the adequacy and reasonableness of their member firms' policies and procedures and their abilities to monitor for fraudulent business activity. For more information and other FINRA examination focus areas for 2010, please visit [www.finra.org/exampriorities/10letter](http://www.finra.org/exampriorities/10letter).

For more information, or to learn about how CCLS may be of assistance, please do not hesitate to contact us at (619) 278-0020.

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<sup>4</sup> [www.finra.org/aml](http://www.finra.org/aml)

<sup>5</sup> [www.finra.org/bcp/pandemic](http://www.finra.org/bcp/pandemic) and [www.finra.org/bcp](http://www.finra.org/bcp)