



BROKER-DEALER - 2018 REGULATORY YEAR IN REVIEW

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Provided by Hardin Compliance Consulting LLC

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We've put together a list of rules, enforcement actions and regulatory developments for broker-dealers for 2018. We recommend that broker-dealers use this review as a resource when updating their compliance programs for 2019.

2018 New & Amended Rules

New [FINRA Rule 2165](#) - Financial Exploitation of Specified Adults (effective February 5, 2018) – This rule allows for firms to place a temporary hold on suspicious disbursements of funds or securities from accounts of Specified Adults under special circumstances. Firms should amend their procedures to address the identification, escalation and reporting of suspected incidents of financial exploitation of Specified Adults. Procedures should also identify, by title, each associated person authorized to place, extend, or terminate a temporary hold. A firm's Firm-Element Continuing Education Plan should include a module addressing the firm's procedures on Financial Exploitation of Specified Adults.

Amended [FINRA Rule 4512](#) - Customer Account Information (effective February 5, 2018) - This rule requires firms to make reasonable efforts to obtain the name of and contact information of a Trusted Contact Person for client accounts. If the new account application utilized by the firm does not include a section for designation of a Trusted Contact Person, the firm should incorporate a separate designation form within the paperwork required at account opening.

- **New [FINRA FAQ – Rules Relating to Financial Exploitation of Senior Investors](#)** – These FAQs were created for new FINRA Rule 2165 and amended Rule 4512.

Amended [FINRA Rule 3310](#) – Anti-Money Laundering Compliance Programs (effective May 11, 2018) – FINRA amended Rule 3310 to more closely align with FINCEN's Customer Due Diligence Requirement for Financial Institutions (CDD Rule). The rule requires that broker-dealers (1) develop and implement procedures to identify and verify the identity of beneficial owners of accounts of legal entity customers on or after May 11, 2018; and (2) understand the nature and purpose of a customer relationship to develop a customer risk profile. The rule requires firms to look for and report suspicious transactions and, on a risk basis, maintain and update customer information ("Fifth Pillar"). The first requirement relates to legal entity customers only. The second requirement applies to all customer accounts, whether natural persons or legal entities, opened on or after May 11, 2018.

Amended [MSRB Rule G-15](#) – Confirmation, Clearance, Settlement and Other Uniform Practice Requirements with Respect to Transaction with Customer (effective May 14, 2018) – These amendments require brokers, dealers and municipal securities dealers (collectively, “dealers”) to disclose additional information, including their mark-ups and mark-downs (collectively, “mark-ups”) to retail customers on certain principal transactions.

Amended [MSRB Rule G-30](#) – Prices and Commissions (effective May 14, 2018) – The rule was amended to provide guidance on prevailing market price (PMP) to determine mark-ups and mark-downs and other Rule G-30 determinations. This amendment establishes factors that must be considered for reasonably determining the PMP, which is used to calculate the compensation to be received. The amendment is intended to enhance transparency for retail investors regarding the costs of their transactions in municipal securities.

- **Updated [MSRB FAQ – Confirmation Disclosure and Prevailing Market Price Guidance \(March 19, 2018\)](#)** – The FAQs were updated to address amendments to MSRB Rule G-15 and Rule G-30.

Consolidated [FINRA Registration Rules](#) (effective October 1, 2018) – The adoption of the consolidated FINRA registration rules restructured the representative-level qualification examinations (by creating a general knowledge examination called the Securities Industry Essentials), transformed the representative-level examinations into specialized knowledge examinations, and updated the related Continuing Education (CE) requirements.

- [1210. Registration Requirements](#)
- [1220. Registration Categories](#)
- [1230. Associated Persons Exempt from Registration](#)
- [1240. Continuing Education Requirements](#)

Amended [MSRB G-3](#) – Professional Qualification Requirements (effective December 20, 2018) – The rule was amended to require municipal advisor principals – those who engage in the management, direction or supervision of the municipal advisory activities of the municipal advisor and its associated persons – to pass the new Municipal Advisor Principal Qualification Examination (“Series 54 examination”).

2018 Notable Regulatory Enforcement Actions

FINRA’s reported enforcements during 2018 resulted in approximately \$96 million in fines and restitution paid by member firms. Common enforcement themes were for violations related to Anti-Money Laundering, Variable Annuity Sales, Registration Requirements, and Sales Practice Supervision. This is a decrease from 2017’s reported fines and restitution of \$139 million. Below are some of the more notable enforcement actions from both FINRA and the SEC during 2018.

[FINRA Fined Wedbush Securities, Inc. \\$1.5 Million for Customer Protection, Net Capital Rule Violations and Related Failures](#) – FINRA determined that Wedbush was not correctly calculating its net capital requirement and was net-capital deficient for a five-month period. FINRA also determined that over a period of five years Wedbush failed to accurately calculate its customer reserve requirement, causing the firm to underfund its customer reserve account on 74 occasions. Wedbush also repeatedly violated, over a period of seven years, the possession and control requirement of the Customer Protection Rule.

[**Ameriprise Financial Services, Inc. Settled SEC Charges Related to Mutual Fund Share-Class Sales for \\$2.2 Million**](#) - Ameriprise settled SEC charges that it overcharged retail retirement clients on mutual fund shares. Specifically, Ameriprise was charged with failing to determine whether its clients could be eligible for less expensive mutual fund share classes. In settling, Ameriprise agreed to pay clients \$1.97 million in avoidable upfront sales charges and was fined \$230,000.

[**FINRA Fined Aegis Capital Corp. \\$550,000 for Anti-Money Laundering and Supervision Rule Violations**](#) – FINRA determined that Aegis’ supervisory system for trading in delivery versus payment (DVP) accounts was not reasonably designed to satisfy its obligation to monitor and investigate trading in these accounts.

[**FINRA Sanctioned Fifth Third Securities, Inc., \\$6 Million for Cost and Fee Disclosure Failures and Unsuitable Recommendations Related to Variable Annuity Exchanges**](#) - In the Letter of Acceptance, Waiver, and Consent, FINRA found that Fifth Third failed to fulfill its obligations under a prior AWC related to its VA business. In that AWC, Fifth Third was cited for making unsuitable variable annuity (VA) exchanges and failing to supervise VA sales. In the 2018 AWC, FINRA found that Fifth Third’s process for VA exchanges did not correct certain deficiencies. The firm’s registered representative made material misstatements and omissions regarding the costs and benefits of VA exchanges. The firm also failed to have a reasonable basis for recommending or approving the exchanges. FINRA also found Fifth Third did not provide adequate training to its principals and registered representatives on how to perform a comparative analysis of the material features of the VAs. Fifth Third was fined \$4 million and was required to pay approximately \$2 million in restitution.

[**SEC Fined Morgan Stanley Smith Barney \\$3.6 Million for Failing to Detect or Prevent Misappropriation of Client Funds**](#) - The [SEC found that MSSB](#) did not have sufficient policies and procedures in place to prevent its advisory representatives from misusing or misappropriating funds from client accounts. The SEC found that although MSSB’s policies required reviews of disbursement requests, the reviews were not reasonably designed to detect or prevent such potential misconduct.

[**FINRA Fined ICBCFS \\$5.3 Million for Anti-Money Laundering \(AML\) Compliance Deficiencies and Other Violations**](#) – Industrial and Commercial Bank of China Financial Services LLC (ICBCFS) was engaged in penny stock clearing and [FINRA determined](#) that the firm did not have a reasonable AML program in place to monitor and detect suspicious transactions, considering the acute risks posed by its business. FINRA also found financial, recordkeeping, and operational violations.

[**FINRA Fined Interactive Brokers \\$5.5 Million for Regulation SHO Violations and Supervisory Failures**](#) - Regulation SHO is designed to limit ongoing naked short positions. The regulation requires that, after a short sale, firms must deliver shares on the settlement date or take action to close out the “failure to deliver” shares by purchasing or borrowing the securities. [FINRA found](#) that Interactive’s supervisory system was not reasonably designed to comply with Regulation SHO. FINRA also found that Interactive repeatedly ignored “red flags” from internal audit, clearing and compliance personnel, its risk assessments, and FINRA exam findings that the firm’s Regulation SHO supervisory systems and procedures were unreasonable.

[**FINRA Fined LPL \\$2.75 Million for Complaint-Reporting and AML Program Failures**](#) - [FINRA found that LPL](#) failed to file or amend registered representatives’ Forms U4 or U5 to disclose dozens of reportable customer complaints. FINRA also found that the Firm provided inaccurate guidance to employees regarding the investigation and reporting requirements associated with suspicious activity as part of its

AML program. Consequently, LPL failed to investigate numerous attempts to gain unauthorized access to systems and potentially illegal activity that should have resulted in the filing of Suspicious Activity Reports.

[FINRA Fined UBS \\$5 Million for Significant Deficiencies in Anti-Money Laundering Programs](#) -- (UBS fined a total of \$15 million by FINRA, SEC and FinCEN) - FINRA fined [UBS Financial Services Inc. \(UBSFS\) and USB Securiteis LLC \(UBSS\)](#) for failure to monitor certain high-risk transactions. UBSFS processed thousands of foreign currency wires for billions of dollars without sufficient oversight. The firm's AML surveillance systems failed to capture important information, such as the identity of customers, the dollar value of the transfers, and whether the transfers involved countries known for money-laundering risk. These failures persisted for more than eight years, and once discovered, the firm took almost five years to implement a more robust system. FINRA also found that UBSS failed to reasonably monitor penny stock transactions that its Swiss parent routed to UBSS for execution through an omnibus account.

[FINRA Sanctioned Merrill Lynch \\$6 Million for Selling IPOs to Industry Insiders](#) - [FINRA found](#) that from 2010 through March 2018, Merrill Lynch made at least 1,462 prohibited sales of IPO shares in 325 different offerings to 149 client accounts in which brokers at other firms or family members of Merrill brokers held a beneficial interest.

[FINRA Fined Morgan Stanley Smith Barney \\$10 Million for AML Program and Supervisory Failures](#) - [FINRA found that Morgan Stanley's AML program](#) failed to meet the requirements of the Bank Secrecy Act and failed to establish and maintain a supervisory system reasonably designed to comply with regulations prohibiting the sale of unregistered securities. The biggest shortcomings? First, Morgan Stanley's AML surveillance system did not get crucial data from other systems, undermining its surveillance of wire and fore currency transfers, including transfers involving countries known for having a high money-laundering risk. Second, Morgan Stanley did not have sufficient resources to review alerts generated by the surveillance system, so employees closed alerts without sufficient review of potentially suspicious wire transfers. Finally, the AML department did not monitor customers' deposits and trades in penny stock for potentially suspicious activity.

2018 Cryptocurrency Developments

[FINRA Charges Broker with Fraud and Unlawful Distribution of Unregistered Cryptocurrency](#) – In the complaint, FINRA alleged that the broker attempted to lure public investment in his worthless public company, Rocky Mountain Ayre, Inc. (RMTN) by issuing and selling HempCoin and by making fraudulent statements about RMTN's business and finances. This case represents FINRA's first disciplinary action involving cryptocurrencies.

[FINRA Investor Alert – Don't Fall for Cryptocurrency-Related Stock Scams](#) – FINRA issued this alert urging investors to use caution before buying shares of companies that tout potential high returns associated with cryptocurrency-related activities.

[Regulatory Notice 18-20: Digital Assets](#) – FINRA issued the notice to encourage firms to promptly notify FINRA if it, its affiliates, or its associated persons, currently engages or intends to engage in any activities related to digital assets, such as cryptocurrencies and other virtual coins and tokens. Until July 31, 2019,

FINRA is asking that each member keep its Regulatory Coordinator abreast of any activities relating to digital assets.

[SEC Administrative Proceeding Imposing Cease-And-Desist Order Against Zachary Coburn \(founder of EtherDelta\)](#) – The SEC charged that EtherDelta had been providing a marketplace for buyers and sellers to trade ethereum tokens, which the SEC deemed to be “digital asset securities.” EtherDelta used an order book, an order display website and a smart contract built on ethereum. Coburn was forced to pay \$388,000 in disgorgement, interest and penalties.

2018 Notable Regulatory Announcements

[FINRA Regulatory Notice 18-18: FINRA Extends Effective Date of Margin Requirements for Covered Agency Transactions](#) (May 3, 2018) – The effective date of the FINRA Rule 4210 amendment establishing margin requirements for Covered Agency Transactions was extended from June 25, 2018 until March 25, 2019.

SEC Proposes [Regulation Best Interest](#) (April 18, 2018) – The proposed regulation would establish a standard of conduct for broker-dealers when making recommendations for any securities transaction or investment strategy involving securities to a retail customer. The proposed standard of conduct is to act in the best interest of the retail customer at the time recommendations are made without placing the interests of the broker-dealer ahead of the interests of the retail customer. Check out the [Comments on Proposed Rule: Regulation Best Interest](#).

[FINRA Regulatory Notice 18-15: Heightened Supervision](#) (April 30, 2018) – FINRA Regulatory Notice 18-15 provides guidance on implementing effective heightened supervisory procedures for associated persons with a history of past misconduct. FINRA encourages firms to adopt the practices that are outlined in the Notice to strengthen their existing supervisory procedures, as appropriate.

[FINRA Information Notice: Enhancements to FINRA’s Disclosure Review Process Relating to Public Financial Records](#) (May 18, 2018) –FINRA has improved its disclosure review process, and allows firms to rely on its verification process to comply with the requirement to conduct public searches related to bankruptcies, judgments, and liens under Rule 3110(e). FINRA also allows firms to rely on the fingerprint results obtained through FINRA’s CRD system to satisfy meet their obligations to search public records to identify criminal matters required to be reported on Form U4. FINRA instituted this new process on July 9, 2018, and will conduct a search of public records within fifteen calendar days of a broker-dealer registered representative submitting an initial or transfer Form U4. If the information submitted on U4 is different from FINRA’s search results, FINRA will notify the member firm, after which the firm will have thirty calendar days to amend Form U4 to avoid a late disclosure fee.

[FINRA Announces Initiative to Transform CRD and Other Registration Systems](#) (June 14, 2018) – The transformation aims to increase the utility and efficiency of the registration and disclosure process for firms, investors and regulators, as well as to reduce compliance costs for firms. FINRA’s Board of Governors has approved moving forward with the project, which FINRA expects to complete in 2021.

Click [here](#) for more details on the transformation, including the [New CRD Reference Guide](#), and important information regarding new CRD entitlements.

[MSRB Notice 2018-17: Compliance Advisory for Brokers, Dealers and Municipal Securities Dealers](#) (August 18, 2018) – This Compliance Advisory highlights certain MSRB rules and provides considerations a dealer could use in assessing its policies and procedures for compliance with the applicable rule. Rules addressed: [G-27](#) (Supervision), [G-15](#) (Confirmation Disclosures), [G-30](#) (Prices/Commissions), [G-18](#) (Best Execution), [G-11](#) (Primary Offering Practices), [G-19](#) (Suitability), and [G-23](#) (Standards of Conduct).

[FINRA Regulatory Notice 18-27: Restructured Qualification Examinations and Related Examination Fees](#) (September 6, 2018) – Effective October 1, 2018, FINRA has restructured its representative-level qualification examination program. As part of the restructuring, FINRA developed the Securities Industry Essentials™ (SIE™) examination and revised several of its representative-level qualification examinations. Check out this link for more details: [FINRA Launches New SIE Exam to Streamline Examination Process for Prospective Candidates Entering the Securities Industry](#).

[FINRA Regulatory Notice 18-31: Third-Party Recordkeeping Services](#) (September 14, 2018) - According to FINRA [Regulatory Notice 18-31](#), the SEC considers contractual provisions allowing a service provider to delete or destroy a broker-dealer’s records as a result of non-payment by the broker-dealer to be inconsistent with the retention and undertaking requirements set forth in Securities Exchange Act Rule 17a-4. Destruction of records under such circumstances may result in SEC action against both the broker-dealer and the third party service provider.

[FINRA Publishes 2018 Report on Examination Findings](#) (December 7, 2018) - The 2018 [Report on FINRA Examination Findings](#) (“Report”) is now available as a resource for firms looking to enhance their compliance programs in 2019. The Report identifies common examination deficiencies and highlights policies and procedures that have helped firms comply with certain rules and regulations. The Report focuses on suitability for retail customers, fixed income mark-up disclosure, due diligence for private placements, and abuse of authority. FINRA also included a case study that highlights examination findings from a targeted examination (sweep) of volatility-linked products.

[FINRA Publishes Report on Selected Cybersecurity Practices – 2018](#) (December 20, 2018) – This report provides a detailed review of effective information-security controls at securities firms. The report represents the newest initiative in FINRA’s ongoing effort to help broker-dealers – including small firms – further develop their cybersecurity programs.

2019 Upcoming Rule Amendments

Amended [MSRB Rule G-21 - Advertising \(effective February 7, 2019\)](#) - The amendments to Rule G-21 (i) provide more specific content standards for advertising by brokers, dealers or municipal securities dealers, (ii) revise the rule’s general standards for advertisements, and (iii) reconcile analogous provisions relating to the definition of “form letter” in Rule G-21 with the definition of correspondence in FINRA Rule 2210, on communications. The amendments also include a technical amendment in paragraph (e) to streamline the rule.

Amended [FINRA Rule 4210](#) – Margin Requirements (effective March 25, 2018) – The amendment establishes margin requirements for Covered Agency Transactions.

Amended [FINRA Rule 6730](#) – Transaction Reporting (effective date April 1, 2019) – This amendment to Rule 6730 requires alternative trading systems (“ATS”) that report transactions in U.S. Treasury Securities to the Transaction Reporting and Compliance Engine (“TRACE”) to identify non-FINRA member subscribers on those transaction reports.

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