



## Broker-Dealer – 2020 Regulatory Year in Review

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2020 was a difficult year for broker-dealers as they found themselves not only juggling their regular day-to-day obligations, the implementation of Form CRS and Regulation Best Interest policies and procedures, but having to do so in the middle of a pandemic. As a result, 2020 may feel like a relative blur when it comes to regulatory guidance. Here is a summary of some of the most notable regulatory events (rule changes, enforcement actions, announcements, etc.) that impacted broker-dealers in 2020.

### COVID-19 – Pandemic

The global pandemic impacted all financial firms during 2020. Firms have had to learn new ways to conduct business, execute their supervisory systems, and running an effective compliance program. In response, FINRA and the SEC sought to provide relief (when reasonable) and guidance as needed. Both entities established resource pages on their websites for updates, guidance, and general information to support all firms. Below are links to several regulatory resource webpages:

- [FINRA - COVID-19/Coronavirus Updates and Guidance Webpage](#)
- [FINRA - SEC Guidance and Resources](#)
- [SEC - COVID-19 Quick Reference Guide for Investors and Market Participants](#)
- [SEC - Coronavirus \(COVID-19\) Response](#)
- [SEC - Frequently Asked Questions Concerning the COVID-19 Pandemic and the Broker-Dealer Financial Responsibility Rules](#)

### Regulation Best Interest & Form CRS

[SEC Regulation Best Interest](#) (Reg BI) requires broker-dealers to enhance their standards of conduct beyond suitability and make it clear that a broker-dealer may not put its financial interests ahead of those of a retail customer. [Form CRS](#) requires registered investment advisers and broker-dealers to provide retail investors with simple, easy-to-understand information about the nature of their relationship.

#### Reg BI and Form CRS Resources

- [FINRA – Regulation Best Interest \(Reg BI\) Webpage](#)

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- [SEC - Reg BI, Form CRS and Related Interpretations Webpage](#)

## Hardin Compliance Consulting Resources

- [Form CRS and Regulation BI for Broker-Dealers & Investment Advisers](#)
- [Practical Thought Leadership – Form CRS and Reg BI are Here: Now What?](#)

## Regulatory Updates

[Registration Filings in the new FINRA Gateway: Classic CRD Form U4 Retires April 5; Upcoming FINRA Gateway U4 Enhancements](#) – FINRA rolled out its new FINRA Gateway and will retire certain registration functionality from Classic CRD **on April 5, 2021**. FINRA is encouraging firms to go ahead and use the new FINRA Gateway when processing any Form U4s.

- FINRA also launched its new [Financial Professional Gateway \(FinPro\)](#) that provides individuals (current or former representatives) direct access to resources and tools to manage their securities registration information.

[Regulatory Notice 20-38: FINRA Adopts Rule to Limit a Registered Person from Being Named a Customer's Beneficiary or Holding a Position of Trust for or on Behalf of a Customer](#) – To address potential conflicts of interest relating to registered persons being named beneficiaries or holding positions of trust for personal monetary gain, FINRA adopted new Rule 3241, which creates a uniform standard to govern persons holding positions of trust.

- [Rule 3241](#) became **effective on February 15, 2021** and requires a registered person to decline being named a customer's beneficiary, executor, or trustee unless one of the following conditions is satisfied:
  - The customer is a member of the registered person's immediate family;
  - The registered person provides written notice to the member and receives written approval before being named a beneficiary of a customer's estate or receiving a bequest from a customer's estate; or
  - The registered person does not derive financial gain from acting in such capacity (other than reasonable and customary compensation).
- Full details of the obligations of registered representative and their member firms can be found in the script of the rule that is attached to the Regulatory Notice or using the link to the rule that is provided above.

[Amendment to FINRA Rule 4210: Margin Requirement – Establishes TBA Market Requirements Effective October 26, 2021](#) – FINRA Rule 4210 was amended to establish margin requirements for (1) To Be Announced transactions, including adjustable-rate mortgage transactions, (2) Specified Pool

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Transactions, and (3) transactions in Collateralized Mortgage Obligations, issued in conformity with a program of an agency or Government-Sponsored Enterprise, with forward settlement dates. (Note that the effective date has been postponed several times.)

## ENFORCEMENT ACTIONS

### Enforcement Actions

In 2020, reported disciplinary actions for FINRA members were reasonably in line with the enforcement activity from 2019. See below for a breakdown of the impact of enforcement actions over the last 4 calendar years.

	2017	2018	2019	2020
Firms Expelled	20	16	8	21
Firms Suspended	29	23	43	36
Individuals Barred	492	386	380	270
Individuals Suspended	733	472	537	515
Total Fines	\$64.9 million	\$61 million	\$62.4 million	\$57.2 million
Total Restitution & Disgorgement	\$66.8 million	\$25.5 million	\$28.1 million	\$45.2 million

\*2017 & 2018 data was obtained from the [FINRA Statistics](#) page. Data for 2019 & 2020 was obtained from FINRA's [Monthly Disciplinary Action](#) reports. The statistics are provided as reported, but enforcements are typically reported by FINRA 60 to 90 days after they occurred.

### Observations

- A key driver for registered representative suspensions was their failure to appropriately disclose required information (financial, criminal, other employment, etc.) on Form U4.
- Registered representatives were fined on average \$5,000 when suspended, but fines exceeded \$10,000 for more serious violations.
- When individuals were barred from the industry, it was largely the result of failing to cooperate or provide information to regulators.
- FINRA consistently cited firms for a failure to have or follow reasonably designed written supervisory procedures - especially where there was a failure to establish a reasonable supervisory system, or the firm did not provide adequate resources and training to its supervisors.

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## *Notable Enforcement Cases*

- [FINRA Sanctions Stifel, Nicolaus & Co., Inc. More Than \\$3.6 Million for Violations Involving Unit Investment Trusts](#) – FINRA ordered Stifel, Nicolaus & Company, Incorporated to pay approximately \$1.9 million in restitution to more than 1,700 customers in connection with early rollovers of Unit Investment Trusts (UITs). The firm was also fined \$1.75 million for providing inaccurate information to customers related to rollover costs incurred and related supervisory violations.
- [Merrill Lynch, Pierce, Fenner & Smith Inc. Ordered to Pay \\$7.2 Million in Restitution to Customers Overcharged for Mutual Funds](#) – FINRA ordered Merrill Lynch, Pierce, Fenner & Smith Inc. to pay more than \$7.2 million in restitution and interest to customers who incurred unnecessary sales charges and paid excess fees in connection with mutual fund transactions. FINRA found that the firm did not have reasonable supervisory systems and procedures in place to ensure that more than 13,000 customer accounts received available sales charge waivers and fee rebates.
- [FINRA Fines SG Americas Securities \\$1.55 Million for Submitting Inaccurate Blue Sheet Data](#) –SG Americas Securities, LLC (SGAS) was fined for submitting inaccurate trade data (known as "blue sheets") to FINRA for more than seven years. The firm was also required to conduct a comprehensive review and make revisions to its systems and procedures related to the deficiency.
- [FINRA Fines Interactive Brokers \\$15 Million for Widespread AML Failures](#) –Interactive Brokers LLC was fined for widespread failures in the firm's anti-money laundering (AML) program, which persisted for more than five years. Interactive Brokers was also required to engage an independent consultant to recommend changes to its AML program.
- [FINRA Sanctions Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC More Than \\$2 Million for Supervisory Violations Related to Variable Annuity Switches](#) –Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC (Wells Fargo) were fined \$675,000 for failing to supervise recommendations that customers switch from variable annuities to investment company products. Wells Fargo also agreed to pay more than \$1.4 million in restitution and interest to approximately 100 impacted customers.
- [FINRA Sanctions Transamerica Financial Advisors, Inc. \\$8.8 Million for Supervisory Violations Related to Variable Annuities, Mutual Funds and 529 Plans](#) –Transamerica Financial Advisors, Inc. (TFA) received a \$4.4 million fine for failing to supervise its registered representatives' recommendations of three different products - variable annuities, mutual funds, and 529 plans. TFA also agreed to pay approximately \$4.4 million in restitution to 2,400 impacted customers.

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- [FINRA Announces Interim Progress of Voluntary 529 Plan Share Class Initiative](#) – FINRA launched their *529 Plan Share Class Initiative* in January of 2019. In December of 2020, FINRA announced that its initiative resulted in more than \$2.7 million in restitution and interest to customers owning approximately 3,900 accounts. Morgan Stanley Smith Barney LLC and B. Riley Wealth Management agreed to pay approximately \$1.7 million and \$250,000 respectively, which accounted for the majority of money returned to investors. FINRA's initiative did not include the restitution that [Merrill Lynch, Raymond James & Associates, and Raymond James Financial Services paid of more than \\$12 Million for supervisory failures involving 529 Plan Share Classes](#). Those violations were identified by FINRA prior to launching their initiative.
- [FINRA Orders Worden Capital Management LLC to Pay More than \\$1.2 Million in Restitution to Customers For Excessive Trading and a \\$350,000 fine for supervision violations](#). Worden Capital Management LLC (WCM) was required to pay more than \$1.5 million, including \$1.2 million in restitution to customers whose accounts were excessively traded, and an additional \$350,000 for supervisory and other violations.

## Regulatory Notices

- [FINRA Statement on SEC's OCIE Risk Alerts for Reg BI and Form CRS](#) – The SEC's Office of Compliance Inspections and Examinations (OCIE) released Risk Alerts for [Reg BI](#) and [Form CRS](#). OCIE, since renamed the Division of Examinations, described its expectations for compliance with Reg BI and Form CRS in the alerts. FINRA stated that it would follow the SEC's lead in its examinations on Reg BI and Form CRS compliance.
- [Regulatory Notice 20-16: FINRA Shares Practices Implemented by Firms to Transition to, and Supervise in, a Remote Work Environment During the COVID-19 Pandemic](#) – FINRA shared some best practices from small, mid-size, and large firms about how they transitioned their associated persons and supervisory procedures into a remote work environment.
- [Regulatory Notice 20-21: FINRA Provides Guidance on Retail Communications Concerning Private Placement Offerings](#) – This Notice provided guidance to help member firms comply with FINRA Rule 2210, Communications with the Public, for retail communications concerning private placement offerings.
- [Regulatory Notice 20-23: FINRA Encourages Firms to Notify FINRA if They Engage in Activities Related to Digital Assets](#) – FINRA reminded firms to keep their Risk Monitoring Analyst informed if the firm, its associated persons or affiliates, plan to engage in activities related to digital assets, even those that are not securities.

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- [Regulatory Notice 20-26 FINRA Shares Practices Firms Implemented to Prepare for the LIBOR Phase-out](#) – FINRA reminded firms to evaluate their exposure to LIBOR and how they intend to deal with LIBOR's phase-out.

## Cybersecurity

Firms are increasingly dependent on technology for their business activities and operations, and cybersecurity poses an increasingly larger risk. This trend was even more apparent in 2020 with so many employees working remotely due to the pandemic. Taking advantage of the “work from home” environment, cyber criminals ramped up their attempts to gain access to confidential client information. FINRA will continue to look at cybersecurity measures during its examinations. Expect testing by examiners to determine whether your firm's policies and procedures are reasonably designed to protect customer records and information consistent with Regulation S-P.

Throughout 2020, regulators alerted firms to various threats and providing guidance on steps that should be taken to protect their networks. FINRA warned members multiple times about various phishing attacks and also provided guidance on how to strengthen authentication methods. There were also a couple of alerts from OCIE regarding ransomware attacks and the safeguarding of customer accounts.

### FINRA Phishing Email Notices

- [Regulatory Notice 20-27: FINRA Alerts Firms to Use of Fake FINRA Domain Name](#)
- [Regulatory Notice 20-40: FINRA Alerts Firms to Phishing Email Using Invest-FINRA.org](#)
- [Regulatory Notice 20-35: FINRA Alerts Firms to Phishing Email with Fraudulent FINRA Survey](#)

### FINRA Information Notices

- [Regulatory Notice 20-30: Imposter Registered Representatives Websites](#)
- [Information Notice - 10/15/20: Cybersecurity: Authentication Methods](#)

### OCIE Cybersecurity Risk Alerts

- [Cybersecurity: Ransomware Alert](#)
- [Cybersecurity: Safeguarding Client Accounts against Credential Compromise](#)



## Final Thoughts

The beginning of the year provides everyone with the opportunity to assess their current compliance programs and to address any identified gaps or weaknesses. Recent regulatory notices and enforcement actions can help you identify specific areas to focus on to set your compliance program up for success in 2021.

Check out [FINRA's 2021 Report on Examination and Risk Monitoring Program](#), published February 1, 2021. This report [combines and replaces the Annual Priorities Letter and the Exam and Risk Monitoring Findings Report](#). The SEC just published its [annual examination priorities](#), another “must read” for compliance professionals. These publications can help you prioritize your compliance efforts.

We expect regulators to focus on compliance with Reg BI and Form CRS disclosures in 2021. Given the continued impact of the pandemic, expect examiners to ask firms about changes to compliance and supervision programs to deal with employees working remotely and any adaptations to business operations. Regulators will also focus on firms' cybersecurity programs and digital communications with the public.

The biggest challenges for compliance officers this year will be managing basic compliance blocking and tackling, while at the same time ensuring that the new policies and procedures adopted to deal with Reg BI work as expected. The “work-from-home” environment and ever-increasing cybersecurity threats simply add to the complexities of running a compliance program. Since we are only human, compliance officers need to develop a plan for prioritizing and addressing the greatest risk activities, delegate or outsource where possible, and off-load non-compliance tasks.