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Financial Services Committee
U.S. House of Representatives
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Chairman Wagner, Ranking Member Sherman and Members of the Subcommittee:

Thank you for the opportunity to appear today to discuss the important work that the Financial Industry Regulatory Authority, or FINRA, is doing to fulfill our mission under the federal securities laws to protect investors and safeguard market integrity while facilitating vibrant capital markets.

The last several years have witnessed a period of continued evolution for the securities markets and those who participate in them. Innovations in technology and financial products and services have created many benefits and opportunities for investors, but in some cases have also introduced new risks or challenges that merit thoughtful regulatory responses.

Throughout this time, FINRA has continued to serve an essential role on the front lines of protecting investors and safeguarding markets, supporting the work of the Securities and Exchange Commission (SEC) and operating under its close supervision. Drawing on an industry self-regulatory model that pre-dates the federal securities laws, FINRA has been well positioned to adapt nimbly to change, leveraging innovative technology and deep market expertise to ensure oversight keeps pace with the industry. Today, we continue to enhance our firm and market oversight programs, bring targeted, significant enforcement cases to address misconduct, improve our engagement with member firms and investors and develop new approaches to help investors make informed investment decisions. And we continue our efforts to look over the horizon, engaging with market participants in new ways that support our mission and making investments in human and technology resources to address emerging risks.

FINRA as a Self-Regulatory Organization

FINRA's ability to adapt our oversight to rapidly changing markets is made possible by the American model of self-regulation. Self-regulatory organizations (SROs) like FINRA and the national securities exchanges and clearing agencies have been a cornerstone of American securities markets going back to the earliest days of the nation, well before the adoption of a federal regime for securities regulation. In its current form, FINRA (through its predecessor organizations) has existed since 1939, just after Congress first made the policy choice under the

Securities Exchange Act of 1934 (Exchange Act) and the Maloney Act of 1938 to create the SEC but maintain and enhance the existing SRO structure in support of its work. Since this deliberate choice to build upon the SRO structure rather than rely exclusively on federal agency supervision, Congress and the courts have periodically examined and reaffirmed the system of self-regulation of brokers and dealers to supplement the SEC's regulation of the securities industry.

Organization, Regulatory Programs and Funding

FINRA is organized as a not-for-profit Delaware corporation and serves as an SRO for broker-dealers, working to protect investors and ensure the fair and honest operation of the securities markets. While FINRA is registered with the SEC as a "national securities association" pursuant to the Exchange Act¹ and is subject to extensive SEC oversight, it is not a federal agency, it was not created by the federal government, and no FINRA Board members, officers or employees are appointed by the federal government. FINRA's Board of Governors is composed of both representatives from member firms (including several who are elected to represent different segments of the broker-dealer industry) and non-industry public governors (who comprise the majority of the Board).² In this way, FINRA benefits from diverse perspectives and expertise regarding a range of market, industry, regulatory, operational and governance matters critical to effective policymaking and oversight.³

As the front-line self-regulatory body for broker-dealers, FINRA administers comprehensive regulatory programs that are designed to complement the SEC's broader oversight of the securities markets. Among other things, FINRA adopts rules that supplement those of the SEC, monitors its member firms to assess risks that exist within the firm and industry, examines its member firms for compliance with FINRA and SEC rules applicable to broker-dealers, surveils trading in the securities markets and enforces member firm compliance where necessary.

FINRA also administers programs and facilities that further promote investor protection and education and provide market transparency, including those that:

- screen the proposed business activities of potential new member firms to ensure the firms have proper financial, operational, supervisory and compliance resources and systems;
- register and test securities industry personnel and provide them with continuing education;
- review specified broker-dealers' communications with the investing public to ensure they are fair, balanced and not misleading;

- review public offerings for the fairness and reasonableness of underwriting terms and private placements involving our member firms for potential investor harm;
- provide investors a free tool — BrokerCheck® — to research the professional backgrounds of broker-dealers, investment adviser firms and their investment professionals, including disciplinary histories, along with an array of other free resources and educational content for both novice and experienced investors;
- operate the largest securities arbitration forum in the United States to assist in the fair and efficient resolution of monetary and business disputes involving investors, broker-dealers and individual brokers; and
- collect and disseminate real-time and historical market information for over-the-counter (OTC) trading in the equity and fixed income markets including the Trade Reporting and Compliance Engine® (TRACE®).

FINRA conducts its oversight of broker-dealers in support of the SEC in coordination with the national securities exchanges, which are for-profit SROs that operate and regulate their own markets, and clearing agencies, which are SROs responsible for the clearance and settlement of securities transactions. FINRA does not operate a market or clearing service. FINRA also does not regulate affiliates of broker-dealers or any other financial entities that are not registered broker-dealers, such as investment advisers, mutual funds and other investment companies, insurance companies or banks. Those financial entities are regulated separately by federal and state regulators, without a layer of SRO oversight.

FINRA carries out all its responsibilities at no taxpayer expense. FINRA's activities are funded by a combination of regulatory fees assessed on members, as well as use-based fees for specific services and data we provide to member firms and the public in support of our regulatory mission. All new fees or changes to existing fees must be filed with the SEC. FINRA's Board has adopted Financial Guiding Principles, available on FINRA's website, that govern how we fund our mission, manage expenses, maintain reasonable fees, and sustain appropriate reserves.⁴ FINRA also publishes on its website its annual budget, annual audited financial report and annual report on the use of fine monies.⁵ Like other SROs, FINRA may assess fines on its members or their registered persons. Such fines are accounted for separately, and their use — which must be approved by FINRA's Board — is limited to certain purposes set forth in the Financial Guiding Principles, which generally include initiatives to promote more effective and efficient regulatory oversight or to promote investor education or improved compliance by member firms.

Engagement, Expertise and Accountability

FINRA's SRO model enables it to benefit from extensive engagement on key policy and operational issues with not only the firms that we oversee, but also other market participants, fellow regulators and SROs, academics, investor advocates and the investing public. While FINRA is ultimately responsible for our public-focused mission of investor protection and market integrity, our ability to draw on the expertise of those we regulate and other stakeholders allows us to understand and react quickly to market events, to enhance our regulatory programs and to tailor our rulemaking and other initiatives to meet regulatory objectives efficiently and consistent with supporting innovative and vibrant capital markets.

As described in detail on our website, FINRA engages with industry and non-industry experts and stakeholders through our Board governance (described above) and a network of 13 advisory committees. Nearly 200 industry and non-industry members currently serve on these committees. The industry committee members represent firms of different sizes and business models and various subject matter expertise. One advisory committee exclusively comprises only non-members — including investor advocates, academics, former regulators and asset managers — who provide the perspective of the investing public.

FINRA leverages the advantages of its SRO model in its rulemaking process, which involves extensive stakeholder engagement with the public, our advisory committees, industry members and trade organizations, fellow regulators and SROs. Our rule proposals are accompanied by economic impact analyses from FINRA's Office of Regulatory Economics and Market Analysis (REMA) to help ensure that rules are effective and tailored to achieve their regulatory objectives. All FINRA rule proposals are filed with the SEC and published for comment in the Federal Register. In many instances, interested parties have multiple opportunities to comment on proposals before they are either filed with or approved by the SEC. FINRA staff carefully consider comments in developing and amending rule proposals.

Through ongoing retrospective reviews, we revisit rules to assess whether they continue to make sense in today's markets, taking into consideration changes in technology, business models, investor trends, products and services, and other relevant developments.⁶ In some cases, we have applied the retrospective review process to thematic areas, such as how we can improve the capital formation process, modernize our rules in light of lessons learned during the pandemic, and identify rules or processes that may inadvertently be imposing barriers to participation in the industry or affecting firms or individuals in disparate ways.

An important element of FINRA's SRO model is federal oversight of our actions. FINRA regulates its member broker-dealers and their associated persons in accordance with the statutory requirements set forth in the Exchange Act and the rules adopted by the SEC to implement

those requirements. All FINRA activities are subject to comprehensive SEC examination and oversight. We are examined regularly by the SEC's Technology Controls Program (TCP), Broker-Dealer Exchange Program (BDX) and the FINRA and Securities Industry Oversight Program (FSIO) office, whose primary responsibility is oversight of FINRA. The SEC conducts upwards of 40 oversight inspections and targeted reviews of FINRA operations per year, and FSIO's oversight of FINRA is subject to a General Accountability Office (GAO) audit at least every three years.⁷ Most FINRA rule proposals must be approved by the SEC. And enforcement decisions by our Office of Hearing Officers are public and can eventually be appealed to the SEC and subsequently to the federal courts.

Technology and Innovation

FINRA also draws on stakeholders and our own expertise to understand and then deploy technology to better serve our mission. These technology investments enable FINRA to carry out its regulatory operations more effectively and efficiently while protecting the security and confidentiality of the information and data we possess. For example, as described below, we have invested significantly in the data and applications required to surveil for potential compliance issues and misconduct among billions of market events, and to provide compliance reports to member firms. We continue to build on our early use of cloud computing in regulation, and we have invested in an Advanced Analytics Program that supports our risk identification and other regulatory efforts. We are also carefully studying developments in new artificial intelligence (AI) technologies, including Large Language Models (LLMs) and Generative AI tools, and considering whether there are opportunities to invest our resources in these tools to support our regulatory programs.

FINRA has also focused on the technology that supports the interactions between member firms and FINRA. For example, in 2022, FINRA completed a multi-year digital platform upgrade that allows firms to enhance compliance and reduce costs by improving system interfaces with FINRA. FINRA built the capabilities of this "Digital Experience Transformation" initiative in consultation with the industry, and FINRA's investment is estimated to save the industry more than \$200 million annually in time and direct costs. Another initiative, the Machine-Readable Rulebook, provides an enhanced search tool and application programming interface (API) to make it easier for both individuals and automated systems to navigate and understand FINRA's Rulebook, and we continue to engage with market participants on how to further improve this tool. In the interest of regulatory efficiency, we also recently discontinued a program requiring the reporting of prescribed data by certain member firms because we determined we could obtain the data from alternative sources, resulting in millions of dollars in cost savings benefits to member firms.⁸

Fundamental to our technology investments is the security and confidentiality of the information entrusted to us by member firms, investors and others. With oversight by the SEC, FINRA invests heavily in its cybersecurity program, operating a comprehensive security program designed to mitigate cybersecurity risks and ensure compliance with applicable regulations and laws. FINRA's cybersecurity program is based upon industry best practices and leverages a risk-driven strategy to effectively and efficiently mitigate security threats. FINRA information technology systems are subject to numerous mandatory and voluntary inspections, including regular inspections by the SEC and periodic independent third-party cyber program and governance assessments.

Information Sharing and Compliance Aids

As an SRO, FINRA also shares information with its member firms to help them build stronger compliance programs that better protect investors and the integrity of the markets. Most prominently, each year FINRA issues a detailed report on findings from its oversight programs and the effective compliance practices we have observed. The reports reflect FINRA's commitment to providing greater transparency to firms and the public about our regulatory activities and information about how firms can strengthen their compliance programs. The 2023 Examination and Risk Monitoring Report⁹ covered a broad range of topics, including anti-money laundering, cybersecurity, SEC's Regulation Best Interest (Reg BI), market manipulation, customer order handling and best execution, compliance with short selling requirements and accurate audit trail reporting. FINRA hosts a podcast, FINRA Unscripted, and regularly publishes timely notices and intelligence reports for its member firms on new or emerging compliance issues, fraudulent practices and other potential risks to investors and the industry. We also provide free compliance tools and resources on our website. In addition, FINRA holds conferences, seminars, roundtables, educational programs, webinars and other events each year. These events both allow us to continually share information with our member firms and other interested parties, such as investor advocates, and enable us to gain timely perspectives on market trends and areas of emerging risk that inform our regulatory programs.

Protecting Investors

We draw on all aspects of our regulatory programs to complement the SEC in the protection of those who invest their savings in our markets, particularly retail investors and those most vulnerable to potential abuses. FINRA writes rules and issues guidance to help firms comply with those rules. We regularly examine close to 3,400 member firms. We also conduct ongoing monitoring of firms to gather regulatory intelligence and understand compliance practices. And where we have evidence that firms have fallen short of their regulatory obligations, we investigate and respond appropriately — including through disciplinary actions that address

wrongdoing and deter future misconduct, obtain restitution for harmed investors, order disgorgement of unlawful profits and remove bad actors from the broker-dealer industry.

This core regulatory work includes focusing on compliance with the SEC's Reg BI. FINRA has been carefully examining member firms for compliance with the requirements of both Reg BI and Form CRS and has held firms accountable when they put their own interests ahead of the interests of investors.¹⁰ FINRA also continues to educate and provide compliance resources to firms, and we work closely with SEC staff regarding our examinations and to ensure consistent interpretations of the rules.¹¹ We recently highlighted¹² for member firms the guidance and other available resources related to Reg BI — including a FINRA dedicated webpage¹³ with relevant materials — to support their compliance efforts.

Stopping Misconduct

Strong investor protection naturally includes identifying and stopping misconduct in the markets, particularly fraud and other financial crimes. FINRA gathers intelligence to detect potential misconduct, takes action where we have jurisdiction, refers matters to other regulators and law enforcement where appropriate, and generally shares emerging threats or risks to build awareness and strengthen compliance. For example, this past year FINRA conducted investigations that involved a type of fraud known as “pig butchering,” whereby bad actors approach their victims via social media or messaging applications to build rapport over time and eventually convince the victims to invest money in fraudulent schemes before absconding with the funds. We also investigated fraud tied to small cap IPOs that are subject to pump-and-dump-like schemes and the fraudulent transfer of customer accounts through the Automated Customer Account Transfer Service (ACATS).¹⁴

FINRA also has taken steps over the last several years to help stop fraud and other misconduct before they can take root in our member firms. While our securities markets are fundamentally sound, and the vast majority of the firms and individuals FINRA oversees are dedicated to serving their clients with integrity and professionalism, there are outliers that can pose significant risks to investors. FINRA uses a combination of tools to identify and address these outliers before they can harm investors, including through screening the backgrounds of prospective new entrants, imposing heightened supervisory plans on firms hiring specified individuals with a history of misconduct and conducting focused examinations of firms or individuals exhibiting concerning activity. For firms raising particularly significant risks, FINRA now deploys a cross-departmental team to identify and address all the potential regulatory issues with these firms.

Building on these efforts, FINRA implemented new rules in 2021 and 2022 that use data-driven analytics to proactively address the risks posed by firms and brokers with a significant history of

misconduct. One set of rules focuses on instances where a member firm seeks to on-board brokers with a significant history of misconduct and allows FINRA to assess the events and require approval in some instances before the member firm can move forward. A second set of rules allows FINRA to impose new obligations — after a transparent process of notice, review and consultation — on broker-dealers that have significantly higher levels of risk-related disclosures than their peers, based on numeric, threshold-based criteria. These obligations ultimately create incentives for member firms to change behaviors, such as discouraging firms from hiring high-risk individual brokers that move from firm to firm or terminating individual brokers with significant histories of misconduct.

Protecting Seniors and Other Vulnerable Adults

Fraud and other misconduct can be particularly harmful for senior investors and other vulnerable adults. The number of older Americans is increasing, with those 65 or older expected to represent 22 percent of the population by 2040, up from 17 percent in 2020.¹⁵ Senior investors are often targeted for financial exploitation because of their relative wealth, typically accumulated from a lifetime of work, saving and investing. Based on reports to the federal government, older Americans lose over \$3 billion annually to financial fraud.¹⁶ In addition to their wealth, senior investors may face medical, social, and behavioral risk factors making them vulnerable to financial exploitation.

Through extensive engagement with the public and market participants and a 2019 retrospective rule review,¹⁷ we have sought to understand and address the particular challenges associated with these investors. For example, FINRA put in place the first uniform, national standards to protect seniors by adopting rules that permit a member firm to contact a customer's designated trusted contact person and to place a temporary hold on the disbursement of funds or securities or a transaction in securities where a member reasonably believes financial exploitation may be occurring. Together with an educational and training campaign conducted with the SEC and the North American Securities Administrators Association (NASAA), those provisions have been used to prevent senior investors from losing substantial amounts in a variety of scams and other forms of exploitation.¹⁸ Another recently adopted rule amendment limits persons registered with FINRA from being named a beneficiary, executor or trustee or to hold a similar position of trust on behalf of a customer. Our dispute resolution forum also considers the needs of seniors, for example by providing for expedited arbitration proceedings in matters involving seniors or seriously ill parties.¹⁹

FINRA has provided guidance on sales-practice risks involving senior investors and effective practices, and we created the Securities Helpline for Seniors® that provides older investors with a supportive place to get assistance from knowledgeable FINRA staff related to concerns they

have with their brokerage accounts and investments. Since April 2015, the Helpline has received more than 27,000 calls from seniors and their families in all 50 states and several countries. To date, more than \$8.6 million has been returned to customers due to firms voluntarily investigating issues raised to them by the Helpline and making customers whole, when appropriate.

FINRA's examination program also focuses on a broad range of topics relating to the protection of senior investors, and we have brought disciplinary actions against firms that have mistreated seniors. For example, FINRA expelled two firms this year based in part on findings that the firms had churned the accounts of senior investors.²⁰ Our FINRA Investor Education Foundation also employs national, state and grassroots partnerships to develop and distribute fraud prevention resources, conduct outreach, and train consumers, law enforcement professionals and victim advocates, as well as engages in important research in this area.²¹

Adapting to Trends in New Investors and Digital Interactions

FINRA has long provided resources for investors to educate themselves and make smarter investment decisions. Those educational resources are informed by research that FINRA undertakes or sponsors to better understand investor behavior, attitudes, knowledge and preferences.

Research by the FINRA Foundation has shown that many adults in the U.S. have joined the market since 2020, and the rate of entry has not slowed.²² These new retail investors tend to be younger and more racially and ethnically diverse than those with longer investing experience. They also tend to have lower household incomes and much smaller account balances.²³ A large portion of new investors report using more complex or risky financial products, with over half owning crypto assets, nearly one-third trading options, and about one-in-five purchasing securities on margin.²⁴ Many new and young investors use social media as a source of investment information, and relatively few rely on financial professionals.²⁵ And while new investors do seek out investing information, their investing knowledge often is relatively low.²⁶ However, many new investors are eager to learn, with nearly four in ten citing learning about investing as a reason they opened their first account.²⁷

FINRA has been working to adapt and expand the free, unbiased educational content and tools we provide to better support informed decision making by newer investors. These resources include a fund analyzer that allows investors to compare the impact of fees, expenses and discounts on mutual fund and exchange-traded fund values; a series of online micro-courses, optimized for mobile technology, which cover essential topics for new investors; and BrokerCheck®, which shows the employment history, certifications, licenses, and disciplinary

histories for brokers and investment advisers. In addition, FINRA regularly issues *Investor Insights* articles that explain, in plain language, emerging products, popular strategies and current market trends — and, when appropriate, warn about threats and scams. For example, a recent article suggested some key steps investors can take to safeguard their finances.²⁸

FINRA has also focused on the increased use of social media by member firms. Given that many newer investors turn to social media for investment ideas and consumer reviews of financial service providers, we undertook a targeted exam in 2021 focused on firms' use of social media influencer and referral programs, which have grown sharply in recent years as part of advertising and marketing campaigns. We shared publicly some practices firms have implemented as part of their social media programs²⁹ and also expanded our oversight of social media activities in our risk monitoring and examination programs.

In addition, technology has provided firms with new ways of interacting with investors and providing information to them about the markets and their investments, including through mobile trading apps and digital customer service interfaces. The SEC has taken the lead in considering whether additional regulatory responses to these developments should be pursued, appropriately so given their ability to look across the broker-dealer and investment adviser channels. For example, in 2021, the SEC requested information and comment on digital engagement practices (DEPs)³⁰ that are designed to engage retail investors using a firm's digital platform. Then in July of this year, the SEC proposed new rules on the use of "predictive data analytics,"³¹ which address conflicts of interest involving DEPs, among other things. FINRA will continue to closely monitor the SEC's actions in these areas.

FINRA is also closely monitoring opportunities and risks presented by the use of LLMs and other forms of Generative AI by our member firms. These recent advances hold the promise to enhance and expand access to financial advice, provide new mechanisms for compliance review and market oversight and enable new levels of automation and customized support. We are seeking to collect and disseminate key learnings across FINRA about use cases that member firms or other parties have for Generative AI and the associated risks to investors. More broadly, we are carefully studying the Congressional, White House and Federal Agency frameworks and initiatives that encourage innovation while establishing important guardrails, as well as testing and information sharing requirements around the technology.

Reviewing Options and Complex Products

One feature of the evolving market is the increased interest by retail investors in products outside of traditional equities and bond offerings, including options and complex products that in many cases can be an appropriate part of an investment strategy, but can also present

additional risks. FINRA has paid particular attention to the increased use of options by retail investors, particularly where such investors may not have the financial knowledge and experience to understand these products. The volume of equity options trading has more than doubled since 2018,³² coinciding with the ability for self-directed investors, once approved for options, to actively trade options online without engaging with a professional intermediary. Meanwhile, the core rules governing options accounts, which are uniform across the options exchanges and FINRA, have remained largely unchanged since they were first put in place decades ago.

After publishing a reminder to firms of their options account-related obligations,³³ we followed up in August 2021 with a targeted exam to review firms' practices and controls related to the opening of options accounts, as well as account supervision, communications and diligence. Based on our observations from that review, we published an update on our website in November 2022³⁴ that included key questions for firms to consider as they evaluate whether their supervisory systems are reasonably designed to address risks related to supervising the approval of options accounts — both self-directed and full-service brokerage accounts — and monitoring the trading activity in options accounts.

We have also provided educational information on our website about the use and risks of options³⁵ and recently published an *Investor Insights*³⁶ article that explains the zero days to expiration options strategy (ODTE) — the strategy of buying options right before they are set to expire — that has become popular in recent years.

In 2022, we sought broad public input on whether the current regulatory framework around options and complex products remains appropriate in light of the current market dynamics, including increased access and participation by retail investors.³⁷ We are considering next steps in response to the more than 16,000 comments we received, many from retail investors who emphasized that they valued having the choice to invest in these products.

Addressing Crypto Assets

Another important market development has been the growth in interest in crypto assets — also known as digital assets — and blockchain technology. A limited number of FINRA member firms have begun offering private placements and providing alternative trading systems for certain crypto asset securities, subject to SEC guidance regarding such activities. FINRA screens through our membership application process any newly-registered broker-dealers engaged in (or existing broker-dealers implementing a material change in their business related to) crypto assets. These firms are then subject to the full range of our regulatory oversight described

above, including regular examinations. To date, FINRA has approved 29 firms³⁸ to engage in activities involving crypto asset securities pursuant to applicable SEC guidance.

Certain FINRA member firms may have indirect touchpoints to crypto assets, such as through representatives who have outside business activities or through affiliates that offer crypto assets. To the extent that registered persons of a member firm are engaged in outside business activities involving crypto assets, FINRA rules require that they be appropriately disclosed and, when they involve participation in a securities transaction for compensation, be supervised by the member firm. FINRA rules also require all member firm marketing materials to be fair and balanced and not misleading. This longstanding standard applies to communications by member firms whether or not they relate to crypto assets.

In addition, we continue to improve our capabilities to oversee the potential risks to investors and markets posed by crypto assets. FINRA established a “Crypto Hub” in October 2022 to ensure we are prepared to fulfill our regulatory mission regarding any crypto asset-related activities of our member firms and associated persons. The Crypto Hub is composed of representatives from across the organization working collaboratively to coordinate and manage FINRA’s regulatory work related to crypto assets. This includes FINRA’s work to conduct risk-based examinations and investigations into crypto asset activities being conducted by member firms and associated persons. FINRA also operates a Blockchain Lab that engages in blockchain-related innovation to support and enhance FINRA’s regulatory capabilities.

Strengthening Markets and Capital Formation

Investor confidence is essential to the effective functioning of the securities markets and the ability of issuers to attract and deploy capital. FINRA safeguards our markets by conducting ongoing surveillance of billions of market events for potential misconduct, promoting transparency for market participants through a variety of facilities, and developing key rules and policy initiatives that promote market integrity, better inform investors and reduce transaction costs. FINRA also seeks to facilitate vibrant capital markets through efficient oversight of its members firms, which play a critical role in facilitating virtually every stage of the capital raising process, including underwriting public offerings, advising companies on alternative methods for raising capital, corporate restructuring, acting as placement agents for sales of unregistered securities, operating funding portals, and publishing research reports to educate and inform investors.

Surveilling Markets and Promoting Compliance

In support of the SEC, FINRA oversees and regulates its member firms’ trading across the securities markets. FINRA deploys a range of sophisticated computer algorithms — what we call

surveillance “patterns” — to analyze large amounts of market data and detect potential rule violations. FINRA now actively surveils all reported activity in the equities, options, and fixed income markets. FINRA has enhanced its surveillance patterns with Consolidated Audit Trail, or CAT, data — which has resulted in better-targeted surveillance that fosters more effective and efficient detection and allows FINRA and the SEC to perform better market reconstruction following market volatility events. In addition, as trading strategies become increasingly complex across different market venues and product types, FINRA has invested significantly in the technology required to properly aggregate and normalize market data sets for effective cross-market and cross-product surveillance for potential manipulation, best execution, and a range of other market integrity rules.

FINRA also relies on its sophisticated surveillance to help promote compliance in the first instance — before conduct becomes sufficiently problematic to require investigation or disciplinary action. For example, FINRA provides curated views of its surveillance output back to its member firms in the form of “report cards.” These report cards help firms understand where FINRA has detected potential issues, enabling them to remediate problems more quickly. In 2022, FINRA leveraged its surveillance program to deliver more than 43,000 report cards to firms. FINRA views this kind of compliance support as an essential tool in its mission to promote investor protection and market integrity, as everyone benefits from early issue detection and resolution.

Ensuring Market Transparency

FINRA facilitates transparency in the fixed income and equity markets in several ways, including by operating facilities that make available key information to the market.

In the fixed income markets, FINRA provides critical transparency through TRACE, which facilitates the mandatory reporting of OTC transactions in eligible fixed income securities. Last year marked TRACE’s 20th anniversary, and it was an opportunity to reflect on the many benefits that TRACE has provided to investors in the markets for corporate and agency debt and securitized products, including increased market stability, reduced trade execution costs, facilitation of increased electronic trading, and information for regulators to better surveil the markets.³⁹ FINRA is currently considering enhancements to reduce the trade reporting timeframe for corporate and agency debt and some other TRACE securities in light of the marketplace and technology advancements that have occurred since the current timeframe was established for corporate bonds 18 years ago.

FINRA also continues to pursue a range of TRACE enhancements in other areas. Of particular note, for U.S. Treasury securities, we have proposed expanding TRACE to provide for end-of-day transaction-level information for on-the-run nominal coupons with appropriate dissemination

caps for large trades. This initiative represents an important step in enhancing transparency in the U.S. Treasury securities market to improve price transparency — promoting liquidity and resilience in this critical market, while also mitigating potential information leakage concerns that could negatively impact market behavior.

Commencing last month, FINRA expanded TRACE to require reporting of transactions in U.S. dollar-denominated foreign sovereign debt securities. Transactions in foreign sovereigns generally are subject to a same-day reporting requirement and are not subject to public dissemination at this time. As is usually the case with reporting new data sets, FINRA will assess next steps as it gains experience with the data. Earlier this year in May, TRACE changes took effect that require members to append a modifier to identify corporate bond trades that are part of a portfolio trade when reporting to TRACE — specifically, where the transaction (i) is executed between only two parties, (ii) involves a basket of corporate bonds of at least 10 unique issues, and (iii) is for a single agreed price for the entire basket. This modifier helps investors identify prices that may be away from the current market because the bond was executed as part of a basket of bonds.

FINRA's efforts to enhance investor access to important market information also includes several initiatives for equities. In the coming months, FINRA plans to detail a reporting process for securities lending information — in support of the SEC's recently adopted new Rule 10c-1a. FINRA also is seeking to improve the availability of other short sale-related data in equity securities by increasing both the frequency and content of the aggregated short interest data published free of charge on the FINRA website.

In addition, FINRA is undertaking efforts to provide investors with important information regarding their broker-dealers' order routing practices in OTC equity securities to allow investors to better assess both the quality of the services provided by their brokerage firms and how firms manage potential conflicts of interest. FINRA is further taking steps to facilitate access to members' order execution and order routing reports on its website. We believe these centralization efforts will make it easier for investors and others to retrieve these important reports at a single location.

Cybersecurity

Cybersecurity is a pervasive and ongoing operational risk facing everyone, including our broker-dealer members and the broader financial markets. Given the growing frequency, sophistication and variety of cybersecurity attacks, FINRA has significantly expanded our capabilities overseeing these areas to enable FINRA to adopt a more proactive posture in how we identify, investigate and address the evolving cyber-related threats. We have created a Cyber and Analytics Unit (CAU), which conducts risk-based examinations and complex

investigations of firms and associated persons to ensure compliance with FINRA rules and federal regulations. We also engage regularly with contacts at the SEC, Federal Bureau of Investigation (FBI) and States to discuss both general cybersecurity related threats and trends and specific incidents, and we will refer matters to law enforcement where appropriate.

Our cyber work also includes an expanded communication and engagement strategy aimed at helping firms implement ways to better protect their data and bolster their resiliency. FINRA has enhanced the resources available to our member firms by providing a suite of publications in the form of Regulatory Notices, alerts, advisories, cybersecurity checklists and templates to raise awareness around cyber-related threats, enhance firms' cyber hygiene and promote overall cyber program management.⁴⁰ The information we provide through these materials and other activities empowers firms to react to new developments and implement best practices more quickly. In addition, FINRA has also developed contacts with the FBI, SEC and the States that allow for intelligence sharing and coordination during our cyber investigations, and we recently hosted a cybersecurity "tabletop" exercise with the federal Cybersecurity Infrastructure and Security Agency and other regulatory agencies.

Managing Liquidity and Capital Risks

The events in 2021 involving trading in "meme" stocks raised questions around the relationship between the smooth functioning of markets and how market participants manage their liquidity. Informed by effective practices observed in member firms' existing programs, FINRA recently sought comment on a concept proposal for a liquidity risk management rule that would set forth specific standards for liquidity risk management, including stress test and contingency funding plans, for a subset of firms.⁴¹

The same events in 2021 precipitated the SEC's move to a T+1 settlement cycle that will allow broker-dealers to better manage their capital and liquidity risks. We recently filed amendments to FINRA rules to conform to the new SEC shortened settlement cycle timeframe requirements.⁴² We have published guidance for member firms⁴³ and plan to publish an investor education article to help investors understand what the transition means for them. Also, we finalized amendments to our rules establishing margin requirements for forward settling Mortgage-Backed Securities and related products (sometimes generally referred to as "TBAs"). These rules will help market participants address the potential risk arising from unsecured credit exposures in this very significant market.

Supporting Capital Formation

Strong markets serve an important role in ensuring issuers can obtain the capital they require to build their businesses and, in turn, support growth in the broader economy. FINRA continually looks for opportunities to support capital formation where consistent with investor

protection. In recent years, FINRA has twice launched initiatives to identify how FINRA can help increase the efficiency of the capital formation process — initially in 2017 and again earlier this year.⁴⁴ These initiatives have produced results, including modernization of our corporate financing rule, technological enhancements to FINRA’s Public Offering System and amendments to our research and communications with the public rules to further improve timely information flow to investors regarding increasingly popular exchange-traded fund products. FINRA also implemented new rule amendments that enable syndicate members in public offerings of corporate debt securities to receive most of their earnings within 30 days instead of waiting 90 days, which promotes increased participation in these offerings by smaller underwriting firms and frees up capital that can be used in other activities in support of further capital formation.

We also recently filed with the SEC proposed amendments to our communications with the public rule to permit projections of performance in communications to institutional investors and specified private placement-related communications to qualified purchasers.⁴⁵ This proposal would allow more investment information to be communicated to an appropriate audience to improve investor decision making and capital allocation, while facilitating greater use of registered broker-dealers in the sales process.

In addition to these rule changes seeking to improve the efficiency of capital formation, we also seek to support compliance by our member firms in their capital raising activities. For example, we conducted a review of member firms’ offering of and services provided to Special Purpose Acquisition Companies (SPACs) and their affiliates. That review focused on areas such as reasonable investigation, best interests, disclosure of outside business activities or potential conflicts, net capital and supervision, and we shared information from the review so that firms could strengthen their processes around using SPACs as a capital raising vehicle.⁴⁶

Conclusion

As the markets continue to change and retail investors are presented with both new opportunities and risks, FINRA remains firmly focused on its statutory mission of working in support of the SEC to protect investors and promote vibrant capital markets. FINRA will continue to learn, evolve and improve, seeking to become the best self-regulatory organization we can be, and we look forward to maintaining our ongoing engagement with Congress, other regulators, market participants and the public as we pursue our mission.

¹ See 15 U.S.C. 78o-3.

² See FINRA By-Laws, Article VII, Sec. 4.

³ FINRA’s governance structure is described in detail on FINRA’s public website and includes the biographies and committee assignments of its Board members. See <https://www.finra.org/about/governance>.

4 See https://www.finra.org/sites/default/files/finra_financial_guiding_principles_0.pdf.

5 See <https://www.finra.org/about/annual-reports>.

6 See <https://www.finra.org/about/finra-360/progress-report/retrospective-rule-review>.

7 The GAO triennially engages in a comprehensive review of FSIO's oversight of FINRA per Section 964 of the Dodd-Frank Act.

8 See *Regulatory Notice* 23-17 (October 2023).

9 See 2023 Report on FINRA's Examination and Risk Monitoring Program, available at <https://www.finra.org/rules-guidance/guidance/reports/2023-finras-examination-and-risk-monitoring-program>

10 As of November, FINRA had issued settlements with 21 firms or individuals for Reg BI or Form CRS violations and filed disciplinary complaints against three individuals that include Reg BI violations. FINRA has expelled two firms whose misconduct included Reg BI violations.

11 Earlier this year, we published *Regulatory Notice* 23-08 (May 2023), which provided guidance on the application of Reg BI to recommendations of private placements to retail investors.

12 See *Regulatory Notice* 23-20 (December 2023).

13 See <https://www.finra.org/rules-guidance/key-topics/regulation-best-interest>.

14 See *Regulatory Notices* 22-21 (October 2022) and 23-06 (March 2023).

15 See The Administration for Community Living, U.S. Department of Health and Human Services, 2021 Profile of Older Americans (November 2022).

16 See, e.g., U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN), Advisory on Elder Financial Exploitation (June 15, 2022).

17 See *Regulatory Notice* 19-27 (August 2019).

18 See Protecting Senior Investors 2015-2020: An Update on the FINRA Securities Helpline for Seniors, Other FINRA Initiatives and Member Firm Practices, available at <https://www.finra.org/rules-guidance/key-topics/senior-investors/protecting-senior-investors-2015-2020>.

19 See Expedited Proceedings for Senior or Seriously Ill Parties, available at <https://www.finra.org/arbitration-mediation/rules-case-resources/special-procedures/expedited-proceedings-seniors-seriously-ill>.

20 See SW Financial, Case No. 2020065599101 (May 11, 2023) (FINRA AWC) and Monmouth Capital Management LLC, Case No. 2022076459303 (August 6, 2023) (FINRA AWC).

21 For more information, see <https://finrafoundation.org/people-we-help/protecting-consumers> and <https://finrafoundation.org/networks-we-strengthen/fighting-fraud>.

22 See New Investors 2022: Entering the Market in Novel and Traditional Ways, available at <https://www.finrafoundation.org/sites/finrafoundation/files/New-Investors-2022-Entering-The-Market-In-Novel-and-Traditional-Ways.pdf>.

23 *Ibid.* See also Investing 2020: New Accounts and the People Who Opened Them, available at https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf.

24 See Investors in the United States: The Changing Landscape, available at <https://www.finrafoundation.org/sites/finrafoundation/files/NFCS-Investor-Report-Changing-Landscape.pdf>.

25 For example, nearly half of Gen Z investors reported using social media to learn about investing and financial topics, compared to less than one-third who said they rely on financial professionals. See Gen Z and Investing: Social Media, Crypto, FOMO, and Family, available at <https://www.finrafoundation.org/sites/finrafoundation/files/Gen-Z-and-Investing.pdf>.

26 On a 10-question investing knowledge quiz, investors with less than two years of investing experience could, on average, answer 3.6 questions correctly, compared to 5.3 for those with 10 or more years of investing experience. See Investors in the United States: The Changing Landscape, available at <https://www.finrafoundation.org/sites/finrafoundation/files/NFCS-Investor-Report-Changing-Landscape.pdf>.

27 See Investing 2020: New Accounts and the People Who Opened Them, available at https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf.

28 See <https://www.finra.org/investors/insights/how-avoid-bad-financial-luck-friday-13th>.

29 See <https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/sweep-update-feb2023>.

30 See Securities Exchange Act Release No. 92766 (August 27, 2021), 86 FR 49067 (September 1, 2021).

31 See Securities Exchange Act Release No. 97990 (July 26, 2023), 88 FR 53960 (August 9, 2023).

32 See Options Clearing Corporation Annual Volume and Open Interest Statistics at <https://www.theocc.com/market-data/market-data-reports/volume-and-open-interest/historical-volume-statistics>.

33 See *Regulatory Notice* 21-15 (April 2021).

34 See <https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/sweep-update>.

35 See <https://www.finra.org/investors/investing/investment-products/options#overview>.

36 See <https://www.finra.org/investors/insights/zeroing-in-options-trading-strategy>.

37 See *Regulatory Notice* 22-08 (March 2022).

38 Three of the 29 approved firms have since withdrawn their membership.

39 See <https://www.finra.org/media-center/blog/trace-at-20-reflecting-advances-transparency-fixed-income>.

40 See, e.g., Guidance related to Cybersecurity at <https://www.finra.org/rules-guidance/guidance/by-topic?term=3686>.

41 See *Regulatory Notice* 23-11 (June 2023).

42 See Securities Exchange Act Release No. 99075 (December 4, 2023) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2023-017).

43 See, e.g., *Regulatory Notice* 23-15 (September 2023).

44 See *Regulatory Notice* 23-09 (May 2023).

45 See Securities Exchange Act Release No. 98977 (November 17, 2023), 88 FR 82482 (November 24, 2023) (Notice of Filing of File No. SR-FINRA-2023-016).

46 See <https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/sweep-update-oct2023>.