



Interim Report on Use of 2017 Fine Monies

FINRA is a not-for-profit, self-regulatory organization dedicated to promoting investor protection and market integrity in a manner that facilitates vibrant capital markets. One of FINRA's tools for achieving this objective is fair and effective enforcement of our members' compliance with securities laws and regulations.

FINRA's highest priority when it identifies misconduct is to seek restitution for harmed investors. However, like many other self-regulatory organizations in the securities industry, FINRA also imposes fines on its members to discourage further misconduct. Fine amounts are based on public, pre-established guidelines and the facts and circumstances of the individual case. FINRA does *not* target any minimum amount of fines to be collected. FINRA does not budget for fines in its operating budget, and fine monies are not considered in determining employee compensation and benefits.

FINRA policy has long required that fine monies be allocated to capital and strategic initiatives. In January 2018, we updated and enhanced this policy as part of a broad review of FINRA's financial resources that we undertook under the FINRA360 organizational improvement initiative. The [Financial Guiding Principles and summary of our 2018 budget](#), which we released in January, provide more transparency about how we manage our financial resources to ensure we fulfill our regulatory responsibilities and further our mission. With respect to fine monies, these Principles also adopted enhanced governance procedures, usage restrictions and transparency requirements.

As the Principles describe, beginning with the 2018 fiscal year, fine monies are now accounted for separately and any use of fine monies must be approved, separately from other expenditures, by FINRA's Board or its Finance, Operations and Technology Committee (Finance Committee). The Board or Committee may authorize the use of fine monies only for one of four enumerated purposes:

- > capital/initiatives or nonrecurring strategic expenditures that promote more effective and efficient regulatory oversight by FINRA (including leveraging technology and data in a secure manner) or that enable improved compliance by member firms;
- > activities to educate investors, promote compliance by member firms through education, compliance resources or similar projects, or ensure our employees are highly trained in the markets, products and businesses we regulate;
- > capital/initiatives required by new legal, regulatory or audit requirements; and
- > replenishing reserves in years where such reserves drop below levels reasonably appropriate to preserve FINRA's long-term ability to fund its regulatory obligations.

The Financial Guiding Principles state that we will itemize and disclose our use of fine monies on an annual basis, starting with fines collected in 2018. In order to provide additional transparency and help inform that disclosure, however, FINRA is providing this interim report describing how we used fine monies collected in 2017 to further the four purposes established by the Principles.

As a retrospective assessment of activities undertaken in 2017, this interim report is not intended to reflect FINRA's full implementation of the Principles published in January of 2018 and their requirements related to fine monies. In particular, the requirement for separate Board or Finance Committee approval for the use of fine monies for particular projects was not in place during 2017; therefore, the projects described in this report reflect management's allocation, after consultation with the Board's Finance Committee, of how 2017 fine monies were used based on the four categories outlined in the Principles. The first full report reflecting implementation of the Principles will follow next year and address how we used fine monies that were collected in 2018.

Summary

As we noted in the [2017 Annual Financial Report](#), FINRA collected \$64.9 million in fines in 2017.

| |
|---|
| : |
| Expenditures funded by 2017 fines collected |
| : |
| \$64.9 million |
| : |
| Expenditures funded by reserves |
| : |
| \$1.1 million |
| : |
| Total 2017 expenditures funded by fines and reserves |
| : |
| \$66.0 million* |

*Note: This total reflects the sum that FINRA expended in 2017 on capital/initiatives, strategic expenditures and the other activities identified below that are eligible to be funded by fine monies and includes funding of \$1.1 million from reserves in addition to the total fines collected. Additional investments in initiatives not eligible to be funded by fine monies were funded from our reserves.

FINRA allocated the \$66.0 million to initiatives that fall under two broad categories that align with the purposes set forth in the Principles:

| |
|---|
| : |
| Initiatives supported by fine money |
| : |
| Capital/initiatives and strategic expenditures that promote more effective and efficient regulatory oversight by FINRA or that enable improved compliance by member firms, and capital/initiatives that are required by new legal, regulatory or audit requirements |
| : |
| \$49.9 million |
| : |
| Activities to educate investors, promote compliance by member firms or ensure FINRA employees are highly trained |
| : |
| \$16.1 million |

The initiatives we undertook in 2017 with the support of fine monies further FINRA's goals to implement efficient oversight programs that protect investors and the markets, strengthen our ability to track trading across markets, modernize critical securities industry infrastructure, facilitate compliance among member firms and equip investors with the knowledge and resources they need to capably navigate ever-evolving markets. A more detailed report on how these functions were supported by fine monies is provided below. Some of these projects are ongoing, multi-year initiatives that have extended into 2018 and in some cases will continue beyond.

Capital/Initiatives and Strategic Expenditures

Enhancing FINRA's Risk-Based Analytics to Better Inform Examinations and Investigations

FINRA continuously works to improve the effectiveness and efficiency of our examination program. In 2017, we allocated \$15.4 million in fine monies to capital/initiatives designed to support a multi-year project to enhance our framework for examinations and investigations and better align our limited resources with the risks and business practices of our member firms. One key area of focus for these initiatives is helping FINRA better identify the brokers and firms that may present the greatest risk to investors and the markets. To do so, we use a number of tools and

analytics to sort and understand the implications of the data we collect, including information about business models and industry relationships, trading activity, disciplinary history, and other disclosures made to FINRA or the public.

- *Examination Analytic Tools*—FINRA invested \$7.3 million in fine monies in technology and related projects to expand the use of our analytics of purchases and sales blotters for trading activity, enhance our analytics of disciplinary histories and other information about all active and inactive firms to better identify individual high-risk brokers and firms, and implement programs to better connect and analyze data across a range of data sources to avoid duplicative regulatory requests and identify potential risks more quickly.
- *Examination and Risk Monitoring Management Platform*—FINRA invested \$8.1 million in fine monies to enhance the technology that supports the examination and risk monitoring platform used by all FINRA examiners and regulatory coordinators to manage their work efficiently, further streamline the management of documents and communications related to member firm examinations, and enhance the reporting and search functions that enable us to more readily identify risks on this platform.

Strengthening Regulators' Ability to Track Trading Across Markets

A comprehensive trade reporting system is an essential part of our work to monitor the integrity of the markets. FINRA's systems process 36 billion equity, options and fixed income market events a day on average and generate billions of additional derived market events by standardizing trading activity across the markets. With the foundation provided by this comprehensive trade reporting, FINRA conducts cross-market surveillance for approximately 99 percent of all trading in U.S.-listed equities markets and 50 percent of all trading in U.S.-listed options. FINRA is also responsible for the surveillance of the unlisted equity market and fixed income instruments that trade in the over-the-counter market, and runs examinations and investigations to identify potential market manipulation or other misconduct. In 2017, we allocated \$27.6 million in fine monies to a range of initiatives to strengthen the ability of FINRA and other regulators to monitor market activity and to support the implementation of reporting enhancements sought by federal regulators.

- *Trade Reporting for Treasury Securities*—FINRA invested \$6.2 million in fine monies to adapt the Trade Reporting and Compliance Engine (TRACE) system administered by FINRA to accommodate the reporting of secondary-market transactions in Treasury securities. This initiative was undertaken in response to a request by the U.S. Department of the Treasury and the U.S. Securities and Exchange Commission (SEC) and is designed to enhance regulatory knowledge and surveillance of the Treasury market.
- *Tick Size Pilot*—FINRA invested \$1.6 million in fine monies in technology and other business operations necessary to implement an SEC-mandated project to require wider quoting and trading increments for certain small-cap equity securities on a pilot basis.
- *Trade Transparency Systems*—FINRA invested \$1.8 million in fine monies to support updates to the core technologies and for other business operations that support fixed income, over-the-counter and TRF transactions trade reporting and a sound audit trail. We enhanced our Multi Product Platform (MPP), which underpins the gathering and dissemination of trade execution and quotation data, as well as Multi Product Platform Repository and the Reference Data Management System.
- *Market Surveillance Patterns*—FINRA invested \$7.9 million in fine monies to further enhance our ability to develop and run sophisticated computer programs or "patterns" that we use to detect a wide variety of compliance issues and suspicious conduct across markets. We enhanced existing equity and fixed income patterns to address new rules and rule changes, developed new cross-market surveillance programs, and increased our surveillance coverage of alternative trading systems by capturing "depth of book" information. We also accelerated the development of new patterns through the use of "machine learning," by which surveillance analysts identify specific instances of behavior of interest and allow algorithms to "train" themselves to identify additional instances in new data sets.
- *Fraud and Market Misconduct Detection*—FINRA invested \$3.9 million to enhance the systems it uses to detect fraud and insider trading. FINRA enhanced its proprietary market surveillance system called Securities Observation News Analysis and Regulation, or SONAR, that the Office of Fraud Detection and Market Intelligence uses to track unusual market activity. We also enhanced the systems that allow us to monitor and analyze "blue sheets," regulatory filings, investor complaints and other sources of regulatory intelligence for potential misconduct. This investment also supported the enhancement of the analytic

systems that the staff uses to review and analyze thousands of surveillance alerts each year, conduct investigations and develop cases as appropriate. In addition, we developed two new supervision report cards for spread manipulation to help firms monitor their activity with respect to anti-manipulative trading rules.

- *Case Management*—FINRA invested \$6.2 million in fine monies to support our ongoing modernization of the platform we use to manage market regulation cases from the initial alert FINRA receives to its disposition. These changes will increase the efficiency of regulatory analysts and managers to research, track and manage regulatory concerns.

Modernizing Securities Industry Infrastructure Administered by FINRA

FINRA administers several key technology systems that support the regulation of brokers and their firms by the SEC, state regulators and self-regulatory organizations (SROs). As the brokerage industry has undergone rapid change, FINRA must ensure that these systems are optimized to adapt to the evolving marketplace. In 2017, we allocated \$5.4 million of fine monies to initiatives to modernize several systems we administer, including the Central Registration Depository (CRD) system, the central licensing and registration system for the U.S. securities industry and its regulators.

- *Registration, Testing and Continuing Education Systems*—FINRA invested \$4.8 million in fine monies to support the ongoing modernization of the registration, testing and continuing education systems that support multiple regulators in their oversight of the brokerage industry. FINRA operates and maintains CRD, which FINRA, in collaboration with the North American Securities Administrators Association (NASAA), developed and introduced in 1981. We are transforming the legacy registration systems to modern systems that use an open source architecture and cloud-based infrastructure to deliver increased effectiveness and efficiency to FINRA, federal and state regulators, the industry and other stakeholders. In addition, we are supporting the major restructuring of securities industry qualifications, including new registration rules that allow individuals who are not affiliated with a firm to take the entry-level Securities Industry Essentials (SIE) exam. FINRA also enhanced the PROCTOR and continuing education systems, which facilitate more than 300,000 exam and continuing education sessions each year, as well as the Financial Professional Gateway that provides current or former representatives direct access to resources and tools to manage their securities registration requirements.
- *Dispute Resolution Program Administration*—FINRA invested \$0.6 million in fine monies to improve the 12-year-old case management system—MATRICS—used to administer the nearly 3,700 arbitration claims and 600 mediation cases brought annually through the dispute resolution program administered by FINRA for the securities industry. We also enhanced the Dispute Resolution Portal, the web-based system that enables customers, firms and arbitrators to electronically submit documents and view their case information.

Improving FINRA Filing Systems for Member Firms

FINRA facilitates member firms' compliance with FINRA rules and the federal securities laws by reviewing documents related to firms' capital-raising activities and arrangements. In 2017, we allocated \$1.5 million to improve the electronic filing systems used by member firms to submit documents for FINRA review. We enhanced the Public and Private Offering Systems through which firms submit offering documents. We also upgraded the Advertising Regulation Electronic Files (AREF) System through which firms submit communications with the public for review, enabling firms to file websites in native format (e.g., html).

Education, Compliance Resources and Training

Educating Investors

An important part of FINRA's work involves providing investors with unbiased information, tools and resources that can equip them to make informed decisions about their assets and the investment professionals with whom they work. In 2017, we allocated \$4.5 million in fine monies to fund various investor education programs.

- *Investor Education Programs*—In 2017, FINRA created, updated and syndicated digital and print publications; developed new, and enhanced existing, interactive tools; delivered in-person education

through outreach efforts ranging from widely attended forums to one-on-one assistance; and provided management oversight as well as program and administrative support to the FINRA Investor Education Foundation to carry out its financial capability-building initiatives. Key initiatives in 2017 included the release of a fully redesigned and modernized Fund Analyzer. This popular tool not only helps investors and financial professionals understand the impact of fees and discounts on mutual funds, exchange-traded funds, exchange-traded notes and money market funds, but it can now calculate and account for any discounts resulting from rights of accumulation or letters of intent. In addition, new advanced features allow users to analyze emerging fund share classes that have variable and firm-specific fee scenarios. We also completed the first phase of a multi-phase bond pricing transparency initiative. When fully deployed, this enhanced investor-focused bond website—known as FINRA Bond Facts—will combine bond-specific data, including recent trade data, with bond education materials. We enhanced FINRA's BrokerCheck tool to make it easier for investors to find and understand relevant information about registered brokers and broker-dealer firms and implemented other changes to further support investor protection, compliance and regulatory uses. We also undertook a comprehensive redesign of the FINRA Investor Education Foundation's website.

Helping Firms Comply With Rules

Through the Member Relations & Education Department and the Gateway Call Center, FINRA provides a number of tools and other resources to help facilitate compliance with FINRA rules and federal securities laws. We spent \$6.6 million of fine monies in 2017 to complete a number of significant initiatives to help improve compliance, especially for smaller firms. For example, we introduced a Compliance Calendar that gives firms a calendar view of regulatory deadlines, upcoming educational programs and other events, including rule effectiveness and implementation dates. We also created a FINRA Compliance Vendor Directory for firms searching for vendors that offer compliance-related products and services, and began developing a Small Firm Helpline to provide direct assistance with answers to general and routine questions.

Training FINRA Examination Staff for the Markets, Products and Businesses That FINRA Regulates

FINRA is expanding its efforts to ensure that the training it provides to staff, including examiners, is sufficient for the work this ever-changing environment demands. In 2017, we allocated \$5.0 million of fine monies for training offered for regulatory purposes, including the creation of a new comprehensive training program for new examiners and the development of targeted programs to enhance the training for existing examination staff to improve understanding of the markets, products, and business models and risks.

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