

**OVERSIGHT OF THE FINANCIAL
INDUSTRY REGULATORY AUTHORITY**

HEARING

BEFORE THE
SUBCOMMITTEE ON CAPITAL MARKETS,
SECURITIES, AND INVESTMENT
OF THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
ONE HUNDRED FIFTEENTH CONGRESS
FIRST SESSION

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OVERSIGHT OF THE FINANCIAL INDUSTRY REGULATORY AUTHORITY

Thursday, September 7, 2017

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
SECURITIES, AND INVESTMENT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 3:15 p.m., in room 2128, Rayburn House Office Building, Hon. Bill Huizenga [chairman of the subcommittee] presiding.

Members present: Representatives Huizenga, Hultgren, Stivers, Wagner, Poliquin, Hill, Emmer, Mooney, MacArthur, Davidson, Budd, Hollingsworth; Sherman, Lynch, Scott, Himes, Foster, Meeks, Sinema, and Gonzalez.

Chairman HUIZENGA. The Subcommittee on Capital Markets, Securities, and Investment will come to order. And without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Oversight of the Financial Industry Regulatory Authority."

I now recognize myself for 5 minutes to give an opening statement.

Hardworking Americans rely on capital markets to save for everything from college to retirement. We, as Congress, must ensure that we have fair and effective regulation in order to maintain efficient capital markets so that all investors receive the greatest return on their investment.

Today, as part of our oversight role, we will examine the Financial Industry Regulatory Authority, or FINRA. FINRA is an independent, not-for-profit organization authorized by Congress and registered with the Securities and Exchange Commission as a self-regulatory organization, or an SRO, that oversees the U.S. securities industries.

FINRA's origins date back to 1939 when Congress authorized the National Association of Securities Dealers (NASD) as an SRO to protect investors and the public interest. The NASD and the NYSE regulation organizations merged in 2007 to form what is now FINRA.

FINRA's mission is to protect investors and promote market integrity through writing and enforcing rules and regulations and examining broker-dealers for compliance with its rules, Federal securities laws, and the rules of the Municipal Securities Rulemaking Board. FINRA drafts, implements, and enforces the rules that gov-

ern the activities of more than 3,700 securities firms and over 630,000 brokers, conducts investor education, registers securities firms, brokers, and mutual fund corporations, operates trade reporting facilities, provides realtime transaction and price data for corporate bond trades, and administers the largest alternative forum specifically designed to resolve securities-related disputes.

As the primary regulatory authority for broker-dealers, FINRA plays an integral part in ensuring that capital markets are fair and efficient, while protecting investors and other market participants. However, some critics have noted that for the last decade FINRA has engaged in some mission creep and transformed itself from a traditional SRO into a quasi-governmental regulator more akin to a fifth branch of Government, or as some have called it, the, “deputy Securities and Exchange Commission.”

While FINRA has regulatory powers that are similar to the SEC, it lacks mechanisms common to other Federal regulators that allow them to be held accountable to Congress and to the public.

Since this committee last held a general oversight hearing on FINRA in 2015, FINRA has appointed Mr. Robert Cook as president and CEO, and there have been a number of significant changes that have taken place at FINRA.

Earlier this year, FINRA announced that it is conducting a comprehensive self-evaluation and organizational improvement initiative called FINRA360. The goal of this effort is to ensure that FINRA is operating as the most efficient and effective SRO, while working to protect investors and promote market integrity in a manner that supports strong and vibrant capital markets. FINRA360—excuse me.

Will the committee room come to order, please?

Thank you.

FINRA360 is a multiyear initiative focused on creating an organization that is committed to continuous improvement, and any changes will be implemented in phases rather than waiting until all areas of inquiry have been fully addressed. As part of FINRA360, Mr. Cook has engaged in a “listening tour” with member firms, investors, investor advocates, regulators, trade associations, and FINRA employees, among other stakeholders, about what FINRA is doing well and what it could do better. I congratulate you on that effort.

Another initiative that took place earlier this year and was discussed during our July 14th hearing on fixed income market structure is the Trade Reporting and Compliance Engine, or TRACE. By working closely with the Treasury, the Federal Reserve, and the FCC, FINRA launched TRACE for member firms to report transactions, post-trade, in U.S. securities. For the first time ever, TRACE provides regulators with regular transaction information for this very important market.

Today, we welcome the testimony of Mr. Cook, which will give us an opportunity to examine the work that FINRA is doing to streamline and improve its operations so as to better serve the broker-dealer community and its customers while ensuring market integrity and facilitating vibrant capital markets.

The Chair now recognizes the gentleman from California, Mr. Sherman, for 5 minutes for an opening statement.

Mr. SHERMAN. Our fine ranking member, Mrs. Maloney, has to be at the White House for a small group meeting with President Trump. I am sure that as a result of that meeting, the President will want to fully fund absolutely every tunnel between New Jersey and New York. And given her persuasive abilities, he will probably also want to fund the new start through the Sepulveda Pass, a subway in my district—or affecting my district. She is very persuasive. In fact, she has persuaded me to note for the record that FINRA is a self-regulatory organization that was originally created in 1938 by the superbly named Maloney Act.

I do not have a full 5 minutes of material here. I will yield to any colleague on our side who wants some time, or I will try to stretch out what material I do have.

I will point out that the chairman has well described the importance, history, and role of FINRA. In 2016 alone, FINRA referred 785 matters to the SEC for possible enforcement. And that, I think, demonstrates quantitatively the important role that they play.

I want to review a few matters. Wells Fargo employees were put under incredible pressure. Any time someone leaves Wells Fargo, a form U5 needs to be created. Some of those U5s indicate that the employee was terminated for creating unnecessary and unasked-for checking or credit card accounts. These employees were put under pressure from on high in their bank. And I am pleased to note that FINRA has a system for going through what I believe is just 207 employees whose U5s indicated they were terminated by Wells Fargo as part of this scandal. And I hope that you will treat those employees appropriately.

I would point out that investment companies need to pay processing fees that pay for the delivery of shareholder reports and proxy materials through accounts held by brokers. I would hope that FINRA would take the lead in making sure that these processing fees are not excessive. They can't really be negotiated. And I look forward to learning how the fee is reasonable and how we move forward to electronic delivery where appropriate. The best way to reduce the fees and costs is to reduce the amount of work that needs to be done.

I would point out that FINRA retains moneys collected in fines. I believe that last year you collected \$173.8 million in fines. About \$27.9 million of that was given to investors as restitution, leaving almost \$150 million for FINRA to spend on certain limited projects.

And I want to make sure that we are not creating a conflict of interest. I have seen where you tell local law enforcement: Go out and enforce drug laws, and you get to keep the property you seize. Seizing the property seems to be the objective. And we will want to be sure that FINRA is making the right decisions, and also that if the right decision is to retain \$150 million, that money is being spent for the benefit of investors.

I think that covers my initial comments. And for the first time ever, I will yield back with time on the clock.

Chairman HUIZENGA. Duly noted.

With that, I would like to take this opportunity to welcome Mr. Robert Cook, President and CEO of the Financial Industry Regulatory Authority (FINRA).

You will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, your written statement will be made a part of the record.

Mr. Cook has a long history involved in this space. From 2010 until 2013, he served as the Director of the Division of Trading and Markets of the U.S. Securities and Exchange Commission. Prior to that, he was a partner based in the Washington, D.C., office of an international law firm where during his years of private practice he worked extensively on broker-dealer regulation advising large and small firms on a wide range of compliance matters.

Mr. Cook earned his JD from Harvard Law School in 1992, a master's of science in industrial relations and personnel management from the London School of Economics in 1989, and an AB in social studies from Harvard College in 1988.

With that, Mr. Cook, we welcome you here. We thank you for your time and your patience. We are a little behind where we had hoped, but as I was taught by one of my Michigan mentors, John Dingell, it was due to, as he called it, "the tyranny of the vote." It doesn't matter what plans you have; as soon as they ring those bells, we have our constitutional responsibility that we need to fulfill. So we appreciate your patience in being here. And with that, you are recognized for 5 minutes.

STATEMENT OF ROBERT W. COOK, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FINANCIAL INDUSTRY REGULATORY AUTHORITY (FINRA)

Mr. COOK. Thank you, Chairman Huizenga, Ranking Member Maloney, Congressman Sherman, and other members of the subcommittee. Thank you for this opportunity to testify before you for the first time as the CEO about FINRA's operations and regulatory programs and how we are protecting investors and ensuring market integrity while facilitating vibrant capital markets.

As you have noted, FINRA plays a critical and active role in the continued strength of the U.S. capital markets. Working closely with the SEC, it is the first line of oversight for thousands of broker-dealer firms and individual brokers. FINRA operates a comprehensive surveillance and examination program to protect investors and the markets.

While the SEC has always closely supervised us, last fall they enhanced their supervision by establishing the FINRA and Securities Industry Oversight, or FSIO, office with roughly 45 staff members who conduct comprehensive reviews of our operations. We welcome this extensive oversight, which is central to the effectiveness of the self-regulatory structure established by Federal statute.

This subcommittee is another important part of our oversight. We welcome your ongoing work and hearings to address the many complex challenges facing the market structure of the equities in fixed-income markets, including the \$14 trillion market for Treasury securities.

As you have mentioned, we recently implemented trade reporting for U.S. Treasuries, working with the Department of the Treasury, the SEC, and the Federal Reserve Board. This initiative leveraged TRACE, FINRA's existing corporate bond trade reporting system,

to limit the burden on the industry and to promote regulatory transparency in this vital market at no cost to taxpayers.

TRACE for Treasuries is a good example of how FINRA can serve investors and the markets effectively and efficiently. In that vein, it is vital that we understand what FINRA does well and what we can do better. That is why shortly after joining FINRA, I embarked on a listening tour, as the chairman noted, to meet the broad range of stakeholders and hear their different perspectives on those questions.

This tour is ongoing. It really needs to be in the DNA of an SRO to be constantly listening. But I have already received important feedback from across the country. Informed by these discussions, we have undertaken a range of new initiatives described in my written testimony, a few of which I will highlight now.

One is FINRA360. This year is FINRA's 10th anniversary, and, with that, I introduced FINRA360 as a multiyear initiative designed to take a fresh look at our operations and to determine how we can more efficient and effective as a regulator.

One of our first actions was to issue a request for comment on how we engage with our member firms, investors, and other stakeholders. We received many helpful comments and are in the process of identifying changes that will help us to be a better SRO. For example, just yesterday we launched a FINRA web page with more information on our board's operations to provide greater transparency on our priorities and our goals.

Also, as a direct result of FINRA360, we recently combined two distinct enforcement teams into one unit under a new head of enforcement who reports directly to me. The unified structure will improve our ability to streamline investigations and provide a more coordinated and consistent approach to oversight.

Other results from FINRA360 include planning the first-ever publication of common examination findings to educate firms and facilitate compliance, identifying additional compliance tools and resources that FINRA can provide to assist smaller firms, and launching an innovation outreach initiative to help FINRA better understand FinTech and to help firms that wish to use FinTech.

In its first months, FINRA360 is already making us better, and we will continue to make additional improvements in the coming year.

Beyond FINRA360, we have worked to strengthen our core regulatory programs and to enhance protections for investors in the markets. We have advanced new initiatives to better identify high-risk brokers and to stop bad actors who put investors at risk. We have requested public comment to update our programs to enhance the capital-raising process, including private securities transactions, while maintaining important investor protections.

We finalized a tailored set of rules for firms with a specific business model that supports capital formation. We have used the Cloud to more efficiently execute our surveillance of more than 37 billion market events each day, enabling us to respond more effectively and more quickly to potential misconduct and to dynamic market conditions.

Last, but not least, senior issues and investor protection are our priority. In 2015, FINRA launched a helpline that takes calls and

investigates issues for investors. To date, we have received over 10,000 calls, and, as a result of this program, firms have voluntarily returned nearly \$4.7 million to customers.

In addition, we recently finalized a new rule to enable firms to put a temporary hold on a disbursement of funds or securities in a senior investor's account when there is reasonable belief of financial exploitation. This rule appears to complement the key work that this committee is doing to protect seniors and vulnerable investors through the SeniorSafe Act. We welcome this opportunity to work with you to provide this important safety net for seniors. To ensure that there are no regulatory gaps in the SeniorSafe Act's coverage, FINRA respectfully requests to be added to the bill's scope.

As you are aware, FINRA's work extends far beyond these initiatives, and I am constantly impressed by the dedication and talent of FINRA's employees who work tirelessly every day to fulfill our mission. But FINRA's ongoing success requires that we strive for continual improvement, and, like our members, are always adapting to market conditions. I believe the major initiatives of this past year, particularly FINRA360, will propel us to face the challenges ahead.

But we must continue to work to stop conduct that is harmful to investors and markets. We must ensure our regulatory operations are appropriately risk-based and running as efficiently as possible. We must continue to innovate and to lead in our use of technology to support cross-market surveillance. And we must continue to work to recognize the diversity of our members, including smaller broker-dealers, and avoid a one-size-fits-all oversight program.

We are in the middle of a self-assessment and organizational improvement exercise that we hope will facilitate transformational change at FINRA. As we continue this exercise, we must remain firmly focused on our core mission of protecting investors and market integrity while promoting vibrant capital markets.

I look forward to working with Congress and other stakeholders to further these important goals. I thank you for your time, and I am happy to answer any questions you may have.

[The prepared statement of Mr. Cook can be found on page 34 of the appendix.]

Chairman HUIZENGA. Thank you. I now recognize myself for 5 minutes for questions. And I want to hit on two things. One, I want to unpack a little bit of some of the things that you have been doing with FINRA360.

But first, I want to start off with this. I, and many others on this committee, have expressed real concern about the decline in the number of companies seeking to go public in the last number of years. And the SEC Chairman, Jay Clayton, has noted that capital formation and making public capital markets more attractive to businesses while providing appropriate safeguards for investors is a top priority.

And I am curious, how can FINRA help with this goal, to help make going public as a company easier and more attractive for smaller businesses? And then how can it encourage other types of capital-raising activities other than going public?

Mr. COOK. Thank you, Mr. Chairman. We agree this is an essential goal that we share with you to help take every step we can to promote capital formation. We recently issued a request for comment on all of our rules that relate to capital raising so that we could take a holistic approach and find out from all industry participants and other interested parties which of our rules can we take a fresh look at in order to help promote capital raising.

Chairman HUIZENGA. What is the timeframe of that? How long ago was that request?

Mr. COOK. It was this year that we issued it. I don't know exactly how many months ago, but it was a number of months ago. We have the comments in.

Chairman HUIZENGA. Okay. So that comment time is closed?

Mr. COOK. Comments are closed. But it is not too late for anyone who wants to give us more comments on that. So we are taking a look at that.

We have also just this year finalized or made operational a new tailored rule set for brokers whom we call capital acquisition brokers, who are engaged primarily in private capital raising, to give them a more streamlined and tailored set of rules to comply with. That became final in April. We already have 30 of these so-called capital acquisition brokers who have registered with us.

We helped to implement the rules relating to funding portals that were mandated by the JOBS Act, and working under the SEC rules we helped facilitate that. We now regulate a number of funding portals.

So I think we are taking a fresh look at our rule book, and we are eager to work with the SEC where we can.

Chairman HUIZENGA. So let me, same coin, different side here, what can we do here in Congress to help encourage that? Do you see it as a problem, this decline in IPOs and publicly traded companies?

Mr. COOK. I think it is a concern that we need to be focused on. We think there are probably many factors driving it, but we want to make sure that where regulation may be a driver, we are thinking about whether that regulation is appropriately calibrated.

When I talk to folks in the industry, things I hear about include possibly raising some of the limits on the funding portals to allow them to be able to raise more money. That is one set of comments we got back.

By the way, I should mention, on our comment period for the capital formation, a number of comments came in that actually don't relate to FINRA rules; they are more SEC rules or Congress. I would be happy to share with you the types of feedback we got from that.

Chairman HUIZENGA. Please. Let's call that CapitalMarkets360. So, we are happy to do that.

Okay. On your FINRA360, you have been meeting with these stakeholders. Is there any kind of industry consensus on improvements that can be made at FINRA? What has been your response so far?

Mr. COOK. I think as part of the listening tour and the engagement notice where we asked anyone interested to share with us their views on how we engage with the world around us, we have

gotten a lot of comments. And that is in part why we created FINRA360, because we needed a process to evaluate those comments and think carefully, how do we respond to this concern or this criticism in a way that will better facilitate investor protection?

A number of the comments relate to internal organizational issues at FINRA and how that translates into the impact that we have on our member firms. So, for example, as I mentioned, we had two enforcement programs historically. And sometimes member firms experienced those as if they were two different regulators. And so that was one of the comments that we got, and we have combined those.

There were other comments about our organizational structure, how we interact with firms. We hear things that firms think we do well, and we need to focus on how we can do more of that and do that more consistently.

Chairman HUIZENGA. I have 30 seconds left. On page 6 of your oral statement, you listed a couple of things that you were working on. You said you have advanced new initiatives to better identify high-risk brokers and stop bad actors who put investors at risk. I am curious, what are those new initiatives, quickly?

And then, that you had finalized a tailored set of rules for firms with a specific business model that support critical capital formation.

So, 5 seconds.

Mr. COOK. Focusing on high-risk brokers is an integral part of our examination program. We attack that through multiple dimensions. The newest elements of it are to create a specialized examination unit just to make sure we are using data and analytics carefully to identify high-risk brokers and to facilitate our examination and oversight of them.

In addition, our board in the last two meetings has approved a series of additional rule amendments to give us greater authority to deal with high-risk brokers or to target activities that we think may be high risk, including, for example, the possibility that if you have a lot of disciplinary events in your background and someone wants to put you in charge of a firm, that you would have to—FINRA would have more opportunities to review that first.

In the testimony, you asked about the tailored rule set. That is really the capital acquisition brokers rule set that we went live in April of this year for those brokers who are primarily engaged in M&A transactions, private equity-type transactions. It is a new initiative creating a tailored rule book to a specific type of firm. These generally are smaller firms. I think we are going to need to look at that and see whether we have gone far enough and whether there is more we can do.

Chairman HUIZENGA. Thank you very much.

And with that, the gentleman from California is passing off to the gentleman from Massachusetts for 5 minutes of questioning.

Mr. LYNCH. Thank you, Mr. Chairman.

I want to thank you, Mr. Cook, for appearing before the subcommittee and helping with our work.

Given the recent attention placed on best execution and conflicts surrounding the payment of rebates to brokers, I was wondering if

FINRA will actually dive in and investigate best execution, and specifically whether the conflict within the maker-taker rule is leading to suboptimal order routing by brokers?

Mr. COOK. Thank you, sir.

Best execution is a vital part of ensuring that customers are getting the best prices and that brokers are not biased in how they execute customer orders.

Mr. LYNCH. That is how it is supposed to work, but that is not how it is working right now.

Mr. COOK. FINRA has done a number of things in the best execution space. The general question of rebates and maker-taker, the SEC's Equity Market Structure Advisory Committee has been looking at that and there are calls for a pilot to look more closely at that.

In the meantime, we have been trying to focus on best execution. We have issued further guidance for firms about best execution. We have conducted a sweep in reviewing a firm's best execution practices. And we are anticipating doing more examination and surveillance work, it has been a high priority on our priorities letter, to focus on how firms, not just how they make the decisions, but how they quantify the benefits to customers of the routing decisions that they are making.

Mr. LYNCH. I have a bill that would set up a pilot as well. But we have been unsuccessful thus far.

Let me ask you, there have been already several high-profile enforcement actions taken by the SEC, by yourself at FINRA, and by the New York Attorney General's Office against broker-dealers who are operating their own alternative trading systems (ATS). And while you have brought actions against them, you haven't called them out or introduced any enforcement action based on their violation of best execution. Is there a reason for that?

Mr. COOK. I think a number of those cases that have come out have been focused on the disclosure that was provided by broker-dealer operators of trading venues and whether those were consistent with how customers' orders were actually being handled as opposed to focusing on best execution. However, how brokers handle best execution, including in the context of ATS's that they run, is a focus of our examination program, and we expect to be bringing forth some more guidance and action in that area.

Mr. LYNCH. Okay. I just want to caution you that the magic of our system, what makes it work, is there is a general feeling that the system is legitimate, that there is integrity there, that people can rely on best execution, that their orders are not being manipulated. That is not what is happening. And I am just worried about the reputational damage that is going to be caused if the current practices continue.

Let me ask you, as reported by Reuters, FINRA makes data available on individual broker's backgrounds, including complaints and sanctions against them, through its BrokerCheck website. However, you reportedly will not release the data in bulk, such as a database that would enable investors and interested researchers to identify whole brokerage firms with high concentrations of brokers with a history of FINRA rule violations.

What is the reasoning behind that, that we can't get the data, everything is individual broker?

Mr. COOK. It is an area we are looking at. Historically, the system has been set up to focus on allowing customers to look at their broker. And over time, I think collectively we are realizing there is more—there is potential opportunity in having them be able to see patterns in their firm. So we have changed our policy on allowing folks to scrape information from our website so that they can pull down that type of information.

We are also looking at whether there are packages of data that we could make available to researchers and others to help facilitate.

Mr. LYNCH. I just worry—my time is short here—but if I wanted to avoid a firm that was toxic and that had a large number of brokers who were violating your rules, I wouldn't be able to do that. You don't give me the information to do that right now in the current form. And I would just ask to you provide that greater protection to investors and parties that want to hold some of the bad actors accountable.

Again, I have exceeded my time. I yield back. Thank you.

Chairman HUIZENGA. The gentleman yields back.

The Chair recognizes the gentleman from Maine, Mr. Poliquin, for 5 minutes.

Mr. POLIQUIN. Thank you, Mr. Chairman.

And thank you very much, Mr. Cook, for being here.

Mr. Cook, I represent the rural part of Maine. They are probably the most hardworking people you can ever find. We have about 3,000 miles of coastline and thousands of lakes and ponds and hundreds of mile of rivers. And we have effectively lost our industrial base over the years because of, frankly, poor public policy when it deals with taxes and regulations and other issues.

But we are now a district of small savers and small businesses. I think 70 or 80 percent—and I won't get this exactly—but 70 or 80 percent of our businesses in Maine employ less than 20 people. So I am very concerned about making sure two things happen for our families in Maine such they can easily save for college or retirement and make sure they have better lives for their families.

So, two things, one of which the chairman just mentioned that dealt with why is it that only about half the number of companies today choose to go public as compared to 10 years ago? I think that has been addressed and likely will continue to be addressed here today.

I would like to focus on the second issue, if I can, Mr. Cook. Last year, as you well know, the Department of Labor, not the Securities and Exchange Commission, but the Department of Labor, got involved in a series of regulations called the fiduciary rule dealing with our broker-dealers to, in my opinion, impose an unnecessary set of new regulations on that part of our financial services community.

Now, if you are a teacher in Lewiston or you are a mechanic in Bangor or you are a lobster fisherman in Downeast Maine, you need to make sure you have access to financial advice, whether it be your insurance agent or your financial adviser who is helping you plan for retirement or what have you. And I am very concerned

that because of these unnecessary regulations, a lot of folks are starting to leave that industry.

So, what do you do with someone who has worked for 20 or 30 years and has a nest egg, which is what they are counting on, but now are unable to get asset allocation advice or do I buy an annuity or not or what stocks or bonds do I invest in, and mutual funds, and so forth and so on?

So my question to you, sir, is, have you seen this among your members, where there are a number of firms that are just not providing advice anymore to small savers and investors that would have a huge impact on the folks that I represent?

Mr. COOK. Thank you, Congressman, for that question. And as a son of—a product of rural Vermont, a neighboring State, I—

Mr. POLIQUIN. I am not sure I would be proud of that, sir. Vermont has no coastline. And I am sure it is a great place to live, but I would hope that your family would consider moving to Maine where you belong.

Mr. COOK. Thank you, sir.

As has been mentioned, I have been going on an ongoing listening tour. I have done 12 roundtables around the country, meeting with small firms. Yes, one of the concerns I do hear from small firms is about how they will comply with the DOL rule. And so that is, especially in a small firm space, I think, an area of concern.

Our view is it would be helpful for investors to have a uniform standard here so that whether you are going in for an IRA account or a non-IRA account or broker investment adviser, that small investor has a nest egg.

Mr. POLIQUIN. Is there confusion now because of this DOL rule that is outstanding?

Mr. COOK. Excuse me?

Mr. POLIQUIN. Is there confusion now among the broker-dealers in our industry because of this DOL rule that is—

Mr. COOK. Frankly, I think it is because of the different standards that have developed up over time even before the DOL rule. We have the broker rule. We have the adviser rule. There are just different—you need a law degree to even know what the open issues are.

Mr. POLIQUIN. Tell us a little bit, if you don't mind, about just the FINRA activities, not those related to the fiduciary rule. What sort of regulations do you put in place, what sort of process do you have in place, to make sure that your members' customers are treated fairly when it comes to conflict of interest?

Mr. COOK. We have extensive rules that all of our members are subject to, suitability requirements, there is particular conflict of interest disclosure requirements they have to make.

And so on top of that rule set, we also have a robust examination program. So it is not just an honor code that they follow, but we come in and examine and surveil followed by enforcement. And that includes everything related to suitability, to supervision, to conversion of customer funds.

Mr. POLIQUIN. Do you find that your members sense this confusion, this additional confusion entered into your space, that the number of orphaned accounts, the number of accounts that are no longer receiving good, sound financial advice has increased?

Mr. COOK. I don't have a sense for numbers or really—I only have anecdotal views that I have heard. I can't really say how widespread any of this is.

But, again, I think there is an issue here that goes prior to the DOL rule about people having different regimes, being subject to different regimes, based on the regulatory requirements.

Mr. POLIQUIN. Thank you, Mr. Cook, for your good work, and I appreciate you being here today.

Thank you, Mr. Chairman. I yield back.

Chairman HUIZENGA. The gentleman's time has expired.

With that, the Chair recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Thank you for being here, Mr. Cook. As I previewed in my opening statement, are you willing or at least open to having FINRA take over responsibility from the New York Stock Exchange for setting and overseeing the processing fees that funds pay for the delivery of shareholder reports and proxy materials to accounts held through brokers?

Mr. COOK. That is a question that we have been focused on. We think the best approach there to figure out what is going on and what the issues are is to get all the parties together and have a dialogue around this so we can figure out what the best regulatory solution would be.

So, ultimately, we think it would be useful to have the SEC, us, the providers of these proxy services, the mutual funds, have a conversation around this and figure out what the best approach is.

Mr. SHERMAN. I hope you will try to reduce the cost to the funds and ultimately to the investors. One way to do that is to have a regulated fee that is as low as it can be. Another is to go to the SEC or to Congress and identify those reports that should be delivered electronically rather than through mail.

Rule 2232 is going to require dealers to begin reporting to their retail customers the amount of markup or markdown on most secondary transactions and corporate bonds. The rule changes are going to take effect in May of next year. However, many dealers subject to the rule are concerned about meeting the deadline, in part because there is no turnkey vendor with compliance solutions that is available today. Are you considering extending the implementation date for this rule?

Mr. COOK. Thank you. So we are engaged closely with the industry, representatives of the industry, to understand what the implementation challenges are around this rule. Fundamentally, the rule is intended to give investors more disclosure, more information, so they can make more informed decisions. But we recognize that there are some challenges that firms need to focus on in order to implement.

We have been coordinating closely with the MSRB, which has a parallel rule, and conversations with the SEC. We have issued some guidance that we think will be helpful. But we are looking at whether there may be more guidance that we could provide, including based on whether a vendor concept develops that would help firms with the operational aspects.

Mr. SHERMAN. Thank you. In my opening statement I talked about the \$173-plus million you receive in fines. Are you consid-

ering returning a greater percentage of the money to the investors? And does FINRA intend to make a more robust, meaningful public report on how it uses these fine moneys?

Mr. COOK. The fine moneys that we collect are an important part of funding important investor protection initiatives. They fund capital initiatives, strategic initiatives. For example, the TRACE for Treasuries platform that we developed at no cost to taxpayers, that type of technology investment is made possible by things like the fine moneys.

The fines go up and down every year. Last year was a large year. But to the extent there is a value in us providing more insight into how we are using the fine moneys, I am very open to—

Mr. SHERMAN. I would hope that you would furnish this committee and the public with a report. It is not exactly taxpayer money, but it is money collected in fines. All of the other fines are imposed by government and we think of it as government money, although it is not collected from taxpayers. And when any government agency is spending money that has come into the government's hands, Congress usually likes to get a pretty good report.

You have a system where you are going to be—you have the Consolidated Audit Trail. You are going to have personally identifiable information, including Social Security numbers, addresses, dates of birth. What is FINRA doing to protect this information gained from this Consolidated Audit Trail program to make sure that it is not hacked?

Mr. COOK. Thank you, sir.

The Consolidated Audit Trail, which was approved by the SEC, FINRA was a bidder to be the processor for that, to be the collector of that information. We were not chosen as the party to do that. So FINRA is not the party collecting the PII. Under the plan approved by the SEC—

Mr. SHERMAN. You have a particular company involved. And I don't know what record do they have. How have they convinced you that they are going to keep this information private?

Mr. COOK. It is a private company. It contracts with the consortium of exchanges to provide this service. I think under the plan they have obligations to keep this information private. But it is a work in progress, and I can't give you any assurances at this point about it.

Mr. SHERMAN. You don't want to be back here explaining why a million investors have had their public information—

Mr. COOK. No, I don't. It is not a FINRA program, though, and FINRA is 5 percent of the voting committee that runs this. So I do think it is a good question for this committee, but it is not a FINRA.

Mr. SHERMAN. You are 5 percent of the committee. I am zero percent of the committee. Please don't come back here to tell us—

Mr. COOK. We all share that interest. Thank you.

Chairman HUIZENGA. The gentleman's time has expired.

The Chair recognizes the gentleman from Arkansas, Mr. Hill, for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman.

Mr. Cook, I'm glad to have you before the committee. One of my favorite expressions over the years was when William O. Douglas

was SEC Chairman. He said that self-discipline is always more welcome than discipline imposed from above. And he was a pretty big supporter of the self-regulatory organizations that were set out by the SEC during his term in office.

It occurs to me, though, that sometimes it is hard to distinguish between what the SEC is supposed to do and what an SRO is supposed to do. And at the end of the day, do you consider yourself a wholly private actor or a state actor with authority from the government when you think about your job as CEO?

Mr. COOK. I think we are a combination that is created by Congress to achieve a certain purpose, which is to facilitate regulation of the markets through active engagement with the industry, drawing on their expertise, not using taxpayer money, not making the government bigger, but at the same time doing it in a way that ultimately serves investors.

So how do you achieve that balance? And I think that is part of the governance structure we have, which is that we have industry representatives on our board, we have industry participation on our committees, balanced by public representatives on our board and careful SEC oversight.

So I think we—we and the other 33 SROs in the securities industry, because we are not the only SRO out there obviously—have been created to undertake this task of achieving an important investor protection mission, but doing it by working closely and collaboratively with the industry where we can.

Mr. HILL. Just because you do so much that is directly related to the safety and soundness of our markets, it speaks to the issue, do we have only to look to the Commission or can we, since you do have that public responsibility, have you submit cost-benefit analysis to us or be subject to the Freedom of Information Act and basic oversight type structures that we have for other public actors? What is your view on that?

Mr. COOK. I think as an SRO—none of the SROs are subject to some of those requirements. And I think the question is, what do we want to get out of the SRO model? And will these requirements or these ideas help facilitate that or undermine it?

I am concerned that if we try to make FINRA look more like the government, that is what we will get, and we may lose certain of the benefits of an SRO model.

However, I think it is also important that we be subject to close oversight. And as I mentioned in my testimony, the SEC has enhanced its oversight of us and is engaged in significant—we have had 24 inspections since the beginning of last year. We have 39 targeted oversight exams. So there is a lot of SEC oversight of us today.

Mr. HILL. Do you really think there is much “self” in the self-regulatory part left after all the court cases of the 1990s and the SEC changes in the direction of FINRA? Is there much “self” left if you are a broker-dealer or someone who used to be deeply involved in the whole oversight of FINRA, in a true SRO-type model?

Mr. COOK. I think it has evolved, for sure. But I think that there are reasons why it evolved. The changes you are talking about that happened in the 1990s were because the SEC determined that

there was undue influence in the industry in this model that was subordinating investors' interest to public interest.

And so there is a recalibration that happened then, but there is still significant involvement by the industry in our activities. And one of the challenges I have is to constantly make sure we got that calibration right. And I think every day we have to be asking ourselves, number one, are we holding the industry accountable? And, at the same time, are we collaborating with them as much as we can? And I don't think that job is ever going to end. I think we are always going to—that is a tension that we have to live with.

Mr. HILL. I appreciate that.

I want to echo Mr. Sherman's concern about the Consolidated Audit Trail, which is not your responsibility. It is the Commission's. And the Commission has a contractee to do that. But we had a lot of data security concerns when FINRA proposed CARDS, which you remember, before your time.

But I am concerned that—I am interested in your view. Is the plan to go to the Consolidated Audit Trail ready for primetime? Should the Commission delay the implementation of the Consolidated Audit Trail?

Mr. COOK. I think there has been a lot of delay so far. So it is challenging to think about more. But the issue of PII that you have raised is significant, and we need to make sure that appropriate protections are in place to protect that data.

And the question of whether you need the PII or not might be one that could be asked, and what are the alternatives to getting it, including might there be other ways of identifying significant traders in the market, like a large trader ID, without having to collect grandma's Social Security number when she only trades once or twice.

Mr. HILL. Good comment.

I yield back, Mr. Chairman. Thank you for the time.

Chairman HUIZENGA. The gentleman's time has expired.

The Chair recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Thank you very much.

Mr. Cook, you have great expertise in investor protection. Two points I would like to ask you.

First of all, I think you all have a toll-free number for seniors. And that is one group that I have been very concerned about. I was a cosponsor with Ms. Sinema on the Senior\$ave Act that you mentioned in your testimony.

For a moment on that, could you acquaint us with how this toll-free line works? My major concern is that oftentimes we allow our technology to get ahead of us. And oftentimes we think we are helping, but we look out and you have robots calling people. And could you tell us, are all of these toll lines manned by human beings who can interact with the seniors and not automation?

Mr. COOK. Absolutely, sir. Yes, especially when we are dealing with a population who may not necessarily be comfortable with technology.

Mr. SCOTT. Right.

Mr. COOK. No. We have staffed this with live people. We track wait times, and they are quite low. And this is a toll-free number

that anyone can call. Frankly, we get calls from people—we have had calls from every State in the country, people ranging from 17 years old to 102 years old, but the average is in the 70's, I believe. And then we follow up and try to figure out what their issues are. Often, we are making referrals to adult protective services or talking to the firm.

And this has actually been a very collaborative approach with the industry. Many large firms have established a key contact person so when we see an issue, we can go to them and they will help us work through and resolve it.

Mr. SCOTT. Okay. Let me go to another concern while I have your investor protection hat on. I know you didn't mention the fiduciary rule in your testimony, but I would like to pick your brain on this for a second.

I have been involved in this issue for quite a while and I have been urging the SEC to come up with a uniform rule, one uniform rule and standard that could be applied. I think their failure to do so has put us in a difficult position.

Now, you have the Department of Labor, you have the SEC, and to some degree even Treasury, with all of these other rules.

So could you walk us through all the different varying standards, DOL versus the SEC, and I don't know if Treasury is coming up with it, and tell us how this complication is making it even more difficult in terms of protection? Could you share how significant and how important it is for us to get a uniform standard?

Mr. COOK. First of all, let me say we support a uniform standard as well. We think that would be most helpful and, frankly, understandable by investors. And we are willing to work with all the relevant agencies to help support that.

Today, I believe you have essentially three different standards: you have the ERISA fiduciary standard, to the extent that you are dealing with qualified retirement accounts subject to ERISA; you have the broker-dealer standard, which involves FINRA oversight compliance with FINRA rules, suitability, and a whole range of other requirements; and then you have the investment adviser fiduciary duty arising under the Federal securities laws. Each one of these was developed in different contexts. And for an investor—my mother is a retired investor living on a small nest egg. I couldn't begin to—her account is with a broker. I don't even want to try to explain to her how these different rules might impact her in different ways. It is very complicated.

Mr. SCOTT. Yes. What do you think it is going to take to get that harmonization? And what do you predict the level of confusion's escalation will be for our failure as a Financial Services Committee? Our committee has that jurisdiction to hammer into these agencies, they have to harmonize, they have to come up with something. What do you think it is going to take to get that to happen?

Mr. COOK. I am not sure. I think there is an opportunity now in some ways that maybe hasn't existed before. I think there is an opportunity, because I often hear from our member firms that they really want to see something happen here and want to promote a uniform standard, because they are the ones on the business end of it, so to speak. They have to explain to customers the different standards that they might be subject to. And so I think that—and

the SEC has put out, opened up a comment file to address this issue. I think there is an opportunity for the SEC and the DOL to work together on this, and we would offer to be as constructive as we can be.

Mr. SCOTT. I agree with you. And we are going to work towards that goal. Thank you.

Chairman HUIZENGA. The gentleman's time has expired.

With that, the Chair recognizes the Vice Chair of the subcommittee, Mr. Hultgren from Illinois, for 5 minutes.

Mr. HULTGREN. Mr. Cook, it's good to see you. Thank you very much for being here. I appreciate your work at FINRA.

I would like to focus my questions and our discussion a little bit on how FINRA encourages competition, especially for small and middle market dealers.

As you know, I sent a letter to you and Chairman Clayton a little bit earlier this year raising some concerns with amendments to rule 4210. I apologize that the letter was a little bit late in the process, so I really do appreciate how quickly you and your staff have been able to address the concerns that I had.

I understand FINRA recently hosted some roundtables that also included stakeholders that have raised concerns with rule 4210 amendments. How do you plan to work with broker-dealers as they implement these rules?

Mr. COOK. Thank you for the question, sir. I think it is important, as we implement rules like this, that we be actively in dialogue with the industry that is subject to them. And as you mentioned, we had several roundtables to talk to buy side, sell side investors, different size firms. We learned a lot about some of the challenges there. I think one of the things we learned is that there is probably an opportunity to provide some more guidance in this area that would help firms with the implementation, and so that is something we are thinking about.

This particular rule that you are referring to, the margin requirement, did come about because of concerns that these long dated transactions historically weren't margins, so there is sort of market risk and investor protection concerns driving this initiative. We also want to make sure we are trying to implement in a balanced way.

Because of the way the margin rules work, they intersect significantly with the SEC's capital rule, and so—and customer protection rule, so we are talking to them as well about the whole overall framework and whether there is opportunities for us to give more guidance. It would be helpful.

Mr. HULTGREN. Great. Yes, I think that would be, and I appreciate that.

Since the creation of FINRA back in 2007, I know there has been a 23 percent reduction in the amount of FINRA-registered broker-dealer members. Similarly, from 2009 through 2016, the ranks of broker-dealers registered with MSRB fell by 26 percent. This trend means less competition amongst dealers. Fewer daily liquidity providers and fewer options for U.S. investors and issuers. By many accounts, increased regulatory burdens have played a significant role in broker-dealer industry consolidation.

How does FINRA assess its rule proposals and current rule book to ensure that its rules are not creating an unnecessary burden on broker-dealer competition, especially the smaller broker-dealers? And I wondered, can this process be improved, given the rate of industry consolidation?

Mr. COOK. Thank you, sir. Yes. I think on the numbers you mentioned, there has been a decline in the number of brokers. The number of registered reps has more or less stayed the same, which implies maybe there is consolidation going on. One thing I think it is also important to note that as compared to some other industries, we actually have new brokers—new firms coming in every year. Last year, we had 120 new broker-dealers come in. We just had more leaving, and that is where the concern arises. It has been going—that story has been the case for the last 15 years.

So I think we need to be cognizant of the impact of our rules on small firms. We need to think about how we can tailor the rule book to the small firm that was—the capital acquisition broker rule book is a good example of how to address that. Engaging careful economic analysis where we take into account the impact of the small firm. In dialogue with our small firm advisory board, which looks at every rule that goes up to our board. And then also thinking about what tools we can provide to small firms to help them comply. I think this is a differentiating feature of an SRO, is that we can and do spend significant resources to try to deliver to our firms tools to help them comply with the rules, whether it is report cards, checklists, online resources. So I think those are all things we need to pursue.

Mr. HULTGREN. And I think you hinted at this, but the FINRA board of directors, specifically the small firm governors, do have an active role in that process, you are hearing from them, is that correct? Do you feel like their voice is heard enough to address maybe some of the concerns here?

Mr. COOK. We have elected small firm governors on our board which has to approve all of our rules. And then we also have a special advisory board of small firms—I actually just met with them this morning—who look at our rule proposals. I think we have to ask ourselves, what more can we do to make sure we are hearing that perspective?

Mr. HULTGREN. In the few seconds I have left, as part of FINRA's recent 360 review, several comment letters urged FINRA to adopt a more rigorous regulatory cost-benefit analysis process, including a required retrospective review of FINRA rules. What processes could FINRA consider adopting to look back at rules that have been adopted to ensure that the economic assumptions that supported the rulemaking were reasonable and accurate?

Mr. COOK. We believe retrospective reviews are essential. We have actually been on the leading edge of this in terms of SROs both in terms of adopting a stated framework for doing an economic analysis and a stated framework for how we will go back and look at our rules from time to time. We actually have several rules that are in the process already or have gone—various stages are going through retrospective rule review. Can we do more? I think that is an area I am very interested in, in beefing up our ability to support that through our chief economist.

Mr. HULTGREN. Great. Thanks, Mr. Cook.
I yield back.

Chairman HUIZENGA. The gentleman's time has expired.

The Chair recognizes the gentleman from Connecticut, Mr. Himes, for 5 minutes.

Mr. HIMES. Mr. Chairman, thank you.

And welcome, Mr. Cook. It is good to see you again. And I say again, because in a year that will not be named, we as sophomores started the social studies program together. And when I have more than 5 minutes, we can have a conversation reflecting on our careers as to whether we learned any marketable skills in that program.

Mr. COOK. That will be an interesting conversation.

Mr. HIMES. But I want to talk with you about something that we have corresponded about, which is the remarkable consistency of IPO gross spread pricing. And just to remind you—I know you have looked at my letter of July 15, 2016—I was very active in promoting and writing and passing the JOBS Act. And the whole premise of the JOBS Act was that Sarbanes-Oxley regulation imposed somewhere between \$1 million and \$3 million in compliance costs for young companies at a time when that was very, very real money for them. And I sort of noted, having done a fair number of IPOs myself, that a 7 percent gross spread on an average IPO of \$100 million in size is \$7 million. So, that is significant money as well. And, the remarkable consistency of 7 percent gross spreads in IPO at least raises questions of whether there is truly a competitive market and whether perhaps our young companies are being asked to bear the cost of a product that is not being priced competitively.

You were kind enough to respond to me in a letter of January 19, 2017, in which you said that you were interested. And you also said that, in light of the recent enactment of the JOBS Act and the SEC rules thereunder, you want to take a look at this subsequent to the JOBS Act. It wasn't clear to me exactly how the provisions of the JOBS Act would have an effect on IPO gross spreads. And in fact, maybe I am wrong, and if it was a competitive market, maybe it would have.

There have been about 1,000 IPOs since the JOBS Act passed. And I can fill in the blank for you here: The median IPO gross spread for IPOs between \$50 million and \$200 million in size, pre-JOBS Act, was 7 percent. There have been 1,000 IPOs since then. The median IPO gross spread since the passage of the JOBS Act is 7 percent. The mean has changed from pre-JOBS Act of 6.94 percent to 6.96 percent. So we are seeing that remarkable consistency yet even after the JOBS Act.

My question for you—and I highlight that because I really think we need to sort of dig in to what is happening here. And I have been careful not to say that it is clear one way or another, but this is real money to our young companies. In the analysis that you provided to me, you basically said there are two competing explanations for this: one is that there is collusive pricing behavior; and the other is that flat pricing of gross spreads can represent an efficient contractual solution for issuers and underwriters by reducing the dimensionality of the contract, and that it simplifies negotia-

tions between the issuer and the underwriter. I candidly don't understand any of that.

So can you help me with how that would be consistent with the competitive market explanatory of consistent 7 percent gross spreads?

Mr. COOK. Thank you, sir, for your continued interest in this. And we are interested in working with you on this. We appreciate the opportunity to have our chief economist talk with your staff about it.

That phrase, "efficient contracting," isn't one we made up, obviously. It is derived from the literature, the academic literature. And I think on your point about whether—you have direct experience in the capital raising process. So I am not going to pretend to be able to—address your firsthand knowledge of it, but I think in terms of your question about how—what has been the impact of the JOBS Act and whether the data shows an impact or not, I would defer to our economist to help advise on whether there has been enough time for the JOBS Act to have a meaningful effect. And in respect to that, I think our letter said we agree with the SEC, because that was their position, I believe, in their response to you that the JOBS Act may have been enough. That all said, sir, we are happy to engage with you on this.

One of the things we feel we are missing in terms of our ability to follow up on this is having access to all the relevant parties, the issuers in particular, and there are some very sophisticated issuers, sponsors who routinely engage from private equity transactions in IPOs to talk to some of them about what is going on. Do they feel they have the opportunity to negotiate? So we would be happy to work with you.

Mr. HIMES. And I totally appreciate that, I really do. I think that is what should happen. And, again, just intuitively this notion that the JOBS Act was about simplifying the IPO process. And I think it did so dramatically in very positive ways. Again, I am not an economics Ph.D., but simplification should theoretically lead to lower pricing, and it manifestly has not. So, again, this is just another thing that raises important questions.

I am out of time, and I appreciate your response. But I agree completely, this is the moment to bring in players and to look at the data and find out what is happening. Again, I have been very careful not to level accusations here, simply to raise the possibility and to ask that this be looked at. And I will put this into a letter, but I would be grateful for some follow-up on this point.

Mr. COOK. I appreciate that. Just to point out again that to do that, we think we need to partner with the SEC, because they are the ones who have more access to the other relevant parties.

Mr. HIMES. I will talk to them too. Thank you.

And thank you, Mr. Chairman.

Chairman HUIZENGA. The gentleman's time has expired.

The gentleman from Minnesota, Mr. Emmer, is recognized for 5 minutes.

Mr. EMMER. Thank you, Mr. Chairman. And thank you, Mr. Cook, for being here.

I want to talk a little bit about the FINRA360 program that you are doing. You talked when you started today about generally

doing these listening sessions and trying to get feedback. And you started this program that is going to be ongoing, how to get feedback from your members. The comment period closed a while back. Can you give us an idea of how many comments you got when you started asking for their feedback about how you are doing, how FINRA is doing, what they expect?

Mr. COOK. Thank you, sir. We got comments through a special notice we issued on our engagement programs and how we engage with our members and with the public, our committee structure, our rulemaking process. So we got a number of written comments on that. I don't remember the exact number. I am happy to get that to you. But in addition, through the listening tour and other informal interactions we have had with our members, we have also gotten a lot of feedback. And so we are really treating it, whether it is in the comment file or not—and the comment file is not closed, if anyone—we are still willing to take comment from folks about how we can improve our operation.

Mr. EMMER. Sure. Has it been, would you say, on a balance sheet of overwhelmingly positive? Has it been overwhelmingly negative? What have you been getting?

Mr. COOK. We have gotten positive, but we have also gotten negative. And I would say more in the negative category. But a lot of the comments that we have gotten in the negative category have been very helpful to us in terms of identifying aspects of our programs that we could improve. So many of it is very much in the weeds in terms of how we examine firms, the processes we use, the way we request information from them, the technology we have to interface with them.

Mr. EMMER. But isn't this what the real issue is, and what I want to get to in the short time we have is, how are you going to address it? Mr. Hill earlier was asking questions about whether you feel you are more of a government type entity or you are more of a private entity. And he was kind of touching on the edges when it came to disclosures, transparency, what do you think you are responsible for. I think he mentioned the Freedom of Information Act, and you responded that no SRO is subject to the Freedom of Information Act and those requirements. But isn't that the big complaint?

The biggest complaint and my concern is there is no transparency. The membership doesn't know how you are making these decisions. You are supposed to be accountable to the SEC, and you said that there have been some enhancements. But how much accountability is there when there is no publicity of the actual board meetings, what is being discussed, where board members are? How are you going to address those problems, or do you not see them as valid concerns?

Mr. COOK. Transparency and disclosure have certainly been among the comments that we have gotten in the comment file. So we will—we are going through a process where we are organizing these comments, trying to understand how we can best respond to them, and we will be going to our board to talk about proposed responses to these.

There are a number of areas where people have asked for more disclosure, and we will focus on that. I have to say, most of the

member firms I talked to, this is not their number one issue. They are more focused on how our exam program works, is it really risk-based. How are we focusing—

Mr. EMMER. Isn't that because—some of the perception is this has moved to more of a prosecutorial type approach as opposed to a regulatory operation. It is trying to help firms stay in business. Again, the time is going to run out, but you have \$1.6 billion that you are holding in reserve at the end of last year. Why?

Mr. COOK. Collaboration with the industry is very important. The portfolio we have is something that came out of the sale of NASDAQ. So when NASD sold NASDAQ, there were proceeds that came. And the question came up, well, what do we do with these? There were tax issues with giving it out to the members. So the decision was made, let's use this to help fund the regulatory programs going forward. And for example, we haven't raised fees in 5 years.

Mr. EMMER. No, but if I can interrupt, and I am sorry, but you have what have been—the accusation is that your people are paid well above what folks in similar positions would be paid. I think I saw a number, that 7 of your top executives get \$1 million a year, and several of them are at \$900,000. One with incentives and everything else gets \$2.7 million, which doesn't seem to be in line with some of the other SROs that are doing similar functions.

How do we get more transparency about how you are making these decisions, where this money is going, what it is being used for, and why the fees, the fines, et cetera? How do we get more transparency? Because it seems that the SRO model, as you referred to it in the beginning, looked like something different and now it has grown into something that looks, to me, a lot more like a government agency that uses its heavy hand to extract fines, and with the interest, this balance you are talking about of trying to protect the marketplace, but it doesn't—it is not giving me the confidence because there isn't this transparency.

And I see my time has run out, but maybe we can continue this conversation so I can understand better what you are trying to do.

Mr. COOK. I would be happy to continue the conversation. I think you raised important points. This is really why we have FINRA360, to take a look at some of these questions. We have enhanced the website disclosure around our board, for example, just yesterday. There are steps we can take to help advance transparency, and we would be happy to talk with you about what you are hearing—

Mr. HULTGREN [presiding]. The gentleman's time has expired.

Mr. EMMER. Thank you.

Mr. HULTGREN. The gentleman from New York, Mr. Meeks, is recognized for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman.

And, Mr. Cook, thank you for being here. I think this is your first time being before our august committee, so welcome aboard. Let me ask you just a couple of questions. This might have initially predated you, but I am sure you know about, in 2015, the Dispute Resolution Task Force recommended that FINRA gather data on race and gender of its current mediators in order to determine whether FINRA's diversity efforts were making a meaningful change. And I think it was also for your arbitrators. And I think

that—I know that FINRA has complied and made public data on the composition of the newly added arbitrators, but we did not and I have not seen anything in regards to the mediators as it was recommended by the task force.

So I was wondering whether you have gathered similar data on race and gender of your current mediators pursuant to the recommendations of the dispute resolution task force?

Mr. COOK. Thank you, sir. As you noted, the recommendation, which is one we support, to study and then promote the diversity of our rosters is—I don't know the answer to your question about where we are in the mediator versus the arbitrator. I can find that out and follow up with you.

In adopting the recommendations, we have engaged a consultant to help us understand the diversity of our arbitrator roster. In addition, in order to help promote that diversity, we have engaged an adviser to help figure out how to do better recruitment. We have enhanced our own recruitment tools. We have done more marketing through social media and direct market advertising. And we did report that, year over year, we did see a meaningful increase in the number of African-American arbitrators and women arbitrators. We have a lot of work left still to do in that regard. So we are not claiming victory by any means, but it is something we are committed to. And whether the difference between arbitrator and mediator in that answer, I don't know the facts, and I will have to get back to you.

Mr. MEEKS. Great, because I would love to see that data. As I said, I appreciated your intent. And from everyone that I have spoken with, you are moving in the right direction. And I always want to make sure I help give you the little push to do that.

In fact, I think that it would be great if, say, you or someone else from your office would commit to working with me, I look forward to working with you and other members of the Congressional Black Caucus so that we can help you do a better job of recruitment of mediators and arbitrators from various communities, connecting you with, whether it is fraternities or sororities or other professional groups we have, that would be a base which you could work from to get qualified individuals who would be very interested, and certain graduates from Historically Black Colleges and Universities (HBCUs).

So maybe we should continue to have dialogue and conversation in that regard, and we could figure out how we can work closer together to make that happen. Because I know of a lot of individuals who are looking for that opportunity.

Mr. COOK. We would welcome that opportunity. One of the—diversity inclusion, even aside from the arbitration program, is I think we have a significant commitment to it at FINRA. And in part, we want to help promote it in the industry as well. We hosted an annual diversity conference to bring industry participants in to talk about best practices and how we can better ensure that the industry represents the diversity of the investors that we are serving. And so we would welcome the opportunity to work with you further on that.

Mr. MEEKS. That is fantastic. In fact, I can think of—and maybe we can invite you to some functions that we are having where

there would be the appropriate crowd, because we do that a number of times. And whether you or someone that you designate could come and talk about what FINRA—what you are doing and what the opportunities are, because I think that would make a great—

Mr. COOK. We would welcome that opportunity, sir. Thank you.

Mr. MEEKS. Thank you. We appreciate you.

And I yield back the balance of my time.

Mr. HULTGREN. The gentleman from New York yields back.

The gentleman from Ohio, Mr. Davidson, is recognized for 5 minutes.

Mr. DAVIDSON. Thank you, Mr. Chairman.

And thank you, Mr. Cook, for coming here and talking with us today. I want to talk to you a little bit about the consolidated audit trail that is supposed to launch in November 2018. In your opinion, is that on track?

Mr. COOK. Actually, initial reporting is starting in November of this year. And, again, FINRA is not the processor for this audit trail. A private company was selected to do that. They are doing it by contract with a consortium of exchanges. I think it's still a work in progress. And whether the targets will be met or not, I don't know.

Mr. DAVIDSON. Once that is in place, will it replace OATS and electronic Blue Sheets?

Mr. COOKS. It has the potential to—certainly, the goal is once we have a consolidated audit trail, the existing audit trails would go away. Blue Sheets, there is going more of a transition period because the CAD information, we will have it as of the date of the cap, but sometimes we need to go and get information from a year ago or 2 years ago. So over time, though, we will be—this will help us replace the Blue Sheet and reduce the burdens.

Mr. DAVIDSON. There will be some overlap. What is your path to the overlap going away?

Mr. COOK. In terms of the existing audit trail systems that we run versus the consolidated audit trail, we have a rule filing pending with the SEC to lay out a plan for how this would happen. And basically, the goal is to make sure that we have the new information in the consolidated audit trail with sufficient data integrity and reliability so that we could phase out the old audit trails.

Mr. DAVIDSON. So have you put together a migration path yet?

Mr. COOK. There would be a set of criteria set up to determine whether there is sufficient quality of reporting and data integrity of the reporting to rely on the new system so that we could then unwind the old system. There would be a threshold, there would need to be a certain threshold met in terms of reliability of the new system.

Mr. DAVIDSON. And when you say thresholds met, of the consolidated audit trail?

Mr. COOK. Yes, yes.

Mr. DAVIDSON. So you have your own independent way that you are planning to assess whether the consolidated audit trail is working?

Mr. COOK. It has to do with whether the reporting is of sufficient accuracy. Our experience, because we operate the audit trail now, is that when you roll out a new system, there is a high—there is

a lot of work that has to go into it. The compliance goes down in terms of—compliance rates go down. And so we need to make sure that the data reporting coming in is of sufficient quality that we can then let the old system go.

Mr. DAVIDSON. Okay. Well, I am glad to hear that you anticipate a path where there won't be duplication of effort.

Mr. COOK. No, absolutely the goal is to roll off the old platform.

Mr. DAVIDSON. And the last question I have is related to cybersecurity for broker-dealers. What is your assessment of the present situation?

Mr. COOK. I'm sorry?

Mr. DAVIDSON. Cybersecurity, how do you feel firms are doing? FINRA oversees a fair number of them.

Mr. COOK. Yes. This is an area that we all need to be focused on, and I think we have been focused on this in terms of our oversight and examination program. We have approached it in a number of ways. We have issued a report to firms, made it available to firms about best practices in this area. We provided checklists so we can help firms understand how they can develop robust systems. And then in our examination programs, we are working to help them identify potential flaws or gaps. We do see opportunities for improvement in certain areas, and we are working—we would then identify those to the brokers involved. We are seeing a lot of brokers spend significant time, broker-dealers spend time on this and investment in it, but this is one of those areas where the work is never done.

Mr. DAVIDSON. Okay. So there is some overlap on all the things that you talked about. And really to kind of go back, you would like one standard for the fiduciary rule, for example. But yet as a regulatory body, you see the benefit of not having one standard. Why do we need all this duplication of effort in the regulatory environment?

Mr. COOK. I think the cyber environment is an area where there is really a need for more coordination among regulators. There is not one established standard. And so one of the things we are trying to do in our oversight of broker-dealers is not to tell them you have to do it this way or that way to offer them best practices. Obviously, if you see something really egregious, we need to follow up on it, but not to dictate a path, because we recognize many of the firms we regulate are also regulated by other agencies. And so there would be an opportunity here, I think, for whether it is through this committee or through other intergovernmental agencies, to develop a more standardized approach to what is really a crucial area.

Mr. DAVIDSON. I appreciate your respect for the free market in that sense, and I hope you will embrace it for fiduciary rule.

Thank you. I yield back.

Mr. HULTGREN. The gentleman from Ohio yields back.

The gentleman from Indiana, Mr. Hollingsworth, is recognized for 5 minutes.

Mr. HOLLINGSWORTH. Good afternoon. Thank you, Mr. Chairman. And thank you, Mr. Cook, for being here. I really appreciate it. And it has been enlightening thus far.

I wanted to ask about your innovation outreach initiative and talk a little bit about who you talk to about different operations inside FinTech and as well kind of what the feedback has been about FinTech so far and what the progression is with regard to that initiative.

Mr. COOK. Thank you. Well, it is very much in the early stages. We have a committee internally that would help us understand FinTech and be a central source of information intelligence, but we figured we needed to—we thought we needed to ramp up our activity in this area.

Mr. HOLLINGSWORTH. What prompted that, out of curiosity? Was that something that you heard in feedback?

Mr. COOK. Yes, on a listening tour, and also just recognizing that this is a change that is happening in the industry and we really need to be a leader in it. We are a leader in technology in our own operations. I think we have done an enormous amount by way of automating through our cross-market oversight, our surveillance programs. Investing in technology has been big for us. So we are very interested in RegTech, both as a regulator, but also trying to understand how—what is happening in the FinTech space, because this is also an area for promoting small business and firms. So we are setting up a new advisory committee to help us understand what is going on there. We hosted a conference on blockchain in New York a few weeks ago, together with other regulators. And we are going to be conducting a series of roundtables on FinTech, and then we will see.

Our goal is to try to understand what is happening, how we can participate, not how we can regulate, per se. We don't want to direct the outcomes. We also want to understand, are there investor protection concerns? And are there ways in which our rules may be getting in the way unnecessarily of new development?

Mr. HOLLINGSWORTH. Great. And how do you see that unfolding over time?

Mr. COOK. I think we will need to make an assessment of what feedback we get. Are there rules that get identified as, hey, this is a problem for us? People say, I want to introduce this new innovative technology. Sometimes it is a new firm whose old business model is based on innovative technology. Sometimes it is existing firms, so using technology to deliver traditional services in different ways. And what we want to understand is, what is going on? Where are the risks? And are there opportunities for us to change the rules?

Sometimes people talk about creating a sandbox, a regulatory sandbox. We thought that was a potential future step that we could consider, but first let's see if there are actually—help us identify areas where our rules are getting in the way of innovation unnecessarily.

Mr. HOLLINGSWORTH. I imagine given how broadly FinTech has at least the opportunity to impact the financial sector, you are interacting with a lot of other regulators both domestically and internationally on this front. Have you found them to be as receptive to new technology and the opportunities that FinTech might bring as you are?

Mr. COOK. I think we—all of the regulators that we know are interested in this area. They have different ways of approaching it, different ways to understand what is happening. We do have a dialogue with international regulators as well. We are trying to understand best practices. That is partially how we developed our program, our innovation outreach program, was to look at, what are other people doing and how can we adapt it to our own context? But we welcome the opportunity to interact with other regulators, including on understanding how they use technology and to leverage their own oversight functions.

Mr. HOLLINGSWORTH. Yes. I have never heard the term “regtech” before, but I like it. I appreciate that.

So with that, I will yield back, Mr. Chairman. Thank you.

Chairman HUIZENGA. The gentleman yields back.

With that, the gentlelady from Missouri, Mrs. Wagner, is recognized for 5 minutes.

Mrs. WAGNER. Thank you, Chairman Huizenga. And thank you, Mr. Cook, for your testimony this afternoon.

As I am sure everyone in this room knows, and I am sure that Mr. Cook knows, I am not a huge fan of the Department of Labor’s fiduciary rule. In fact, I am having a hard time finding many fans of it. I just came from an event this afternoon where industry stakeholders from both the public and private sectors discussed research that shows the rule is not working. In fact, numerous independent studies of late have concluded that brokerage advice services have been dramatically affected in addition to, “significant operational disruptions and increased costs for financial institutions,” which in turn means increased cost for retail investors, and then the negative effects are just building and building. Further, FINRA’s mission is to safeguard the investing public against fraud and bad practices.

So a simple question, did the Department of Labor consult with you in any substantive way when crafting their current rule?

Mr. COOK. Thank you, Congresswoman. We did have conversation with DOL to give technical advice.

Mrs. WAGNER. Technical advice only.

Mr. COOK. Technical advice to offer our understanding of how the brokerage model works, how our rules work, how what they are proposing might interact with our rules.

Mrs. WAGNER. I guess I am surprised there wasn’t a more substantive discussion about your opinions on the issue, and being one of the primary regulators, did they or did not consult in a substantial measure with you all on this new rule letting?

Mr. COOK. In addition to sort of staff-to-staff technical advice that I mentioned, FINRA did write a comment letter to the DOL during the rulemaking process. This was before my time, so it is not fresh in my mind. But yes, FINRA did offer its comments on the proposed DOL rule. And DOL did take into account a number of elements of our comments.

Mrs. WAGNER. Do you believe the SEC is best suited to enforce and regulate a best interest standard for broker-dealers?

Mr. COOK. I think what is best is to have a uniform standard for broker-dealers across the different channels of advice, different ways of advice.

Mrs. WAGNER. And we currently do not have that, correct?

Mr. COOK. We do not have a uniform standard, no.

Mrs. WAGNER. Yes or no, do you support the DOL's delaying full implementation of the fiduciary rule for 18 months as they continue to study the effects of the rule?

Mr. COOK. I think the delay or not is a decision for them to make. I think what we would like to promote is an environment where there could be consultation between the SEC and the DOL, and we are happy to participate in that to help establish a uniform rule across the different types of investment advice.

Mrs. WAGNER. For broker-dealers specifically?

Mr. COOK. For broker-dealers, but also for investment advisers. So regardless of who you are going to for your retail advice on your trading in securities, that you are—

Mrs. WAGNER. Depending upon the definition of "adviser," they have a fiduciary standard already. We are talking specifically about the DOL rule as it affects broker-dealers.

Mr. COOK. In remarks you gave earlier this year, you talked about how you didn't see yourself as the examination or enforcement regulator under the Department of Labor rule. But you went on to say that if the rule went away and the SEC stepped in, you felt like FINRA would have a role in the process of crafting that rule. SEC Chair Clayton has requested comments in assessing standards of care applicable to investment advisers that are broker-dealers. Can you discuss what role FINRA has played in this process to date, and what role you envision FINRA taking should the SEC move forward with its own rule?

Mr. COOK. Should the SEC move forward, we would appreciate the opportunity to interact closely with them and give, again, technical advice in the crafting of the framework. And then depending on what they came up with, there may be ways in which we need to revisit some of our rules to conform to their approach. So we look forward to engaging fully with the chairman and the commission as they move forward with that initiative.

Mrs. WAGNER. Now, one of the roles FINRA plays is examining firms regarding compliance. I imagine you hear a lot of complaints from broker-dealers. Since June, when DOL's fiduciary rule partially took effect, have you heard from broker-dealers about the implementation?

Mr. COOK. We have heard from, especially smaller firms, about the implementation.

Mrs. WAGNER. And what are those concerns?

Mr. COOK. The smaller firms are concerned about the compliance burdens. I think there are many different business models out there, and it is hard to—what I am sharing with you is purely anecdotal, we haven't done a study of—

Mrs. WAGNER. There have been many studies done, but please.

Mr. COOK. But not from us, so that is all I want to be clear about. And so some small firms have expressed concern about the compliance burdens. Large firms have also indicated that they are able to comply with it in different ways. So I think there is a variety of different responses that we hear.

Mrs. WAGNER. Hmm. Interesting testimony.

I think I have run out of time, Mr. Chairman. I yield back.

Chairman HUIZENGA. The gentlelady's time has expired.

So with that, Mr. Cook, we—

Mrs. MALONEY. Thank you.

Mr. HUIZENGA. With that, on queue.

Mrs. MALONEY. Thank you so much. And I apologize to my colleagues.

Chairman HUIZENGA. We were aware that you had a meeting at the White House.

Mrs. MALONEY. I want to report a bipartisan effort between New Jersey, New York, Republican, Democrat, and the President of the United States to improve the transportation city between the two States. It is important. And it was a great meeting, but I wasn't here for this important hearing.

I just—

Chairman HUIZENGA. With that, let me officially recognize the ranking member here for 5 minutes for her questions.

Mrs. MALONEY. Okay. Thank you so much.

And I just would like to ask a few questions. I tell you, we created this year a Terrorism Financing Subcommittee, Chairman Hensarling did. And it is really important, if they don't have money, then they can't put off their bombs in our great cities and neighborhoods. And so, FINRA's work is really, really important.

Mr. Cook, you noted in your testimony that FINRA has recently started to collect information on transactions in Treasury securities, which will be made available to the regulators. And one of the big debates was whether Treasury transactions should be reported publicly as well. Some market participants thought that this would harm the market because it would allow high-speed traders to see what other investors were doing and jump in front of them. But others thought that increasing the transparency of the market would enhance market quality and bring more investors in.

So what are your thoughts on this? Should transactions in Treasury be reported publicly or just to the regulators? What is your sense?

Mr. COOK. Thank you for that question. The TRACE for Treasury's program is really just—it is new, it just started in July. And so I think what we have an opportunity to do is to look at the data that has come in and understand what we are seeing in ways that we couldn't have done before. And then I think it is—at this point, there are a couple of questions that we need to think about in terms of next steps. One is to make sure that all the relevant parties are reporting into the system. And a program that we rolled out is just for broker-dealers, because those are our members. The Federal Reserve Board had announced publicly that they were going to talk with us about perhaps working on a system so that banks, who can also trade in this market, would also be reporting in.

So I think that before we think about reporting some people's trades and not others, we need to think about whether there are—we have the full scope of the reporting sufficiently covered.

Mrs. MALONEY. Okay. And also, I would like to talk a little bit about cybersecurity. And I know that FINRA identified cybersecurity as one of the examination priorities for you this year. And I think that is very important, because cybersecurity is a huge risk

and it is growing every day. I know that most Members of Congress have been hacked. And cybersecurity is especially important for financial institutions that hold their customers' money, broker-dealers, because one successful cyber attack against a broker-dealer could wipe out millions of dollars of wealth.

So my question is, are you finding that firms have adequate programs in place to mitigate cybersecurity risk or is this an area that we have to continue to shore up?

Mr. COOK. Thank you, ma'am. I think this is an area that we can never lose focus on because it is so important. And the risks are evolving constantly. And so what we have tried to do is to provide more resources to firms to help them develop the best programs they can. We did a report in 2015 that put forth a variety of best practices that firms could follow. We also created a checklist for firms to help them think through, particularly smaller firms, to help them think through how they can protect themselves and their customers data appropriately. And then it has been an exam priority for us.

Yes, we do have findings for certain firms that we then review with them and give them ideas about how they can correct. One of the things that, for example, we see sometimes is that the access by application developers to a live system may be not sufficiently controlled. So when we see these sorts of deficiencies, we work with the firm to help identify potential best practices that they could bring to bear on it. But it is an area that I think we continually need to focus on.

And there is an opportunity, I think, for collectively—and this goes well beyond FINRA—to look across the financial services agencies to really define what are the standards that we need to apply. FINRA should not be making the standards in this area, because there are so many other—by itself certainly, because there are so many other relevant regulators.

Mrs. MALONEY. And also, in your priorities for this year, you included a pilot examination program designed to determine the value of conducting target examinations of smaller firms which have not previously been subject to review due to their small, low-trading volumes. And could you help us by providing an update on the progress of this pilot program? Have you found that firms that haven't previously been examined present any special risk to customers?

Mr. COOK. The pilot which is still underway, so we are still drawing our conclusions from it, was focused on firms. Their trading activity is being collected and it is being surveilled as a whole. We also do exams on these firms. So I don't want there to be an impression that this is the first time these firm would have had an examination. This is really focused on a particular type of examination that we historically had not done for them because their trading volume is so low. And the question was, do we have the thresholds right? We are trying to do a risk-based exam program, and so we are not—I think it is fair to say we are not finding significant issues here, but the pilot is still under way and we will need to draw conclusions once—

Mrs. MALONEY. Thank you. My time has expired. Thank you.
Chairman HUIZENGA. The gentlelady's time has expired.

Mr. Cook, I want to say thank you for your time today. I want to congratulate you again on your efforts with FINRA360 and that examination that is going on. I look forward to continuing this conversation with you, not only on an official basis, but informally as well, as we encourage you to listen to some of the concerns that were expressed here today, as well as some of the lines of questioning. We will look forward to continuing to work with you. And, again, I appreciate your patience on our timing. I know we were a bit thrown off by the votes, and I appreciate your patience on that.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, again, Mr. Cook, thank you.

Mr. COOK. Thank you, sir.

Chairman HUIZENGA. And this hearing is adjourned.

[Whereupon, at 4:50 p.m., the hearing was adjourned.]

A P P E N D I X

September 7, 2017

Testimony of

**Robert W. Cook
President and CEO**

Financial Industry Regulatory Authority

Before the Subcommittee on Capital Markets, Securities, and Investment

Financial Services Committee

U.S. House of Representatives

September 7, 2017

Chairman Huizenga, Ranking Member Maloney, and Members of the Subcommittee:

On behalf of the Financial Industry Regulatory Authority, or FINRA, I would like to thank you for the opportunity to testify today about FINRA's operations and regulatory programs and about how we are fulfilling our mission of protecting investors and ensuring market integrity while facilitating vibrant capital markets.

Since the last time that FINRA testified before Congress at a general oversight hearing in 2015, there have been a number of significant changes at the organization. I joined FINRA as President and CEO in August 2016, and recently William H. Heyman, Vice Chairman and Chief Investment Officer of The Travelers Companies, Inc., was elected as Chairman of our Board of Governors. FINRA also has reached an important milestone this year—we are marking our tenth anniversary since FINRA was created from the merger of the National Association of Securities Dealers (NASD) and the regulatory arm of The New York Stock Exchange (NYSE).

Before outlining FINRA's activities and the steps we are taking to further enhance our organization, I would like to take this opportunity to recognize the Subcommittee's work to address the many complex and challenging issues of the securities industry and markets. Your recent hearings on equity and fixed income market structure, for example, have been instrumental in enriching the dialogue among policymakers and other stakeholders on how our capital markets can better serve investors and issuers.

FINRA plays a critical role in the continued strength of those markets as the first line of oversight for the thousands of broker-dealer firms and individual brokers in the United States. Our regulatory program has evolved with the industry for nearly 80 years, rising to meet the challenges of new markets, new products, and new business practices. In just the last several months, we have implemented trade reporting for U.S. Treasuries (the largest market in the world), continued to expand protections for senior investors,

enhanced our ability to pursue bad actors, requested comments on our entire set of capital formation rules, and launched a new initiative to address the latest developments in financial technology.

But the U.S. securities industry will never stop evolving, and neither can we. That is why earlier this year we commenced a program called FINRA360—a top-to-bottom review dedicated to making FINRA the most effective and efficient self-regulatory organization (SRO) that it can be. Drawing on input from inside and outside the organization, FINRA360 has already resulted in new investments in examiner training, new compliance tools for our member firms, and a newly consolidated enforcement program, among other improvements discussed below.

History of FINRA and SEC Oversight

Strong, vibrant securities markets are central to the U.S. financial system. Companies and individuals around the world rely on these markets to finance growth, create jobs, and fund new ideas; to plan for the future; and to protect against unexpected market events. Trillions of dollars are raised by issuers and traded in the U.S. securities markets every year, and the ability of investors to access these markets depends on thousands of firms and hard-working brokers who serve their customers with diligence and integrity.

FINRA is the first line of oversight for a significant portion of the U.S. securities markets, complementing the work of the Securities and Exchange Commission (SEC) through our regulation of broker-dealer firms and individual brokers. FINRA is organized as a not-for-profit Delaware corporation, registered with the SEC as an SRO, and subject to comprehensive SEC oversight. Every brokerage firm and broker that sells securities to the public in the United States must be registered with FINRA. We do not regulate investment advisers, mutual funds, insurance companies, or banks.

As the SRO for more than 3,700 securities firms, nearly 160,000 branch offices, and over 630,000 individuals, FINRA plays an integral role in protecting the fundamental trust that investors and other market participants place in the U.S. financial system every day. In 2016, for example, we conducted more than 4,100 examinations to test that market participants were operating fairly and within established rules, and we brought more than 1,400 disciplinary actions where we found violations of those rules. In addition to our own enforcement measures, each year we refer hundreds of fraud and insider trading cases to the SEC and other agencies, leading to important actions that can prevent further harm to investors.

Working with securities exchanges, FINRA also conducts cross-market surveillance for approximately 99 percent of all trading in U.S.-listed equities markets and 65 percent of all trading in U.S.-listed options. In addition, FINRA is responsible for the surveillance of the unlisted equity market and fixed income instruments that trade in the over-the-counter (OTC) market. All told, in order to closely monitor trading activity across these markets, our surveillance systems process 37 billion market events a day on average

and generate billions of additional derived market events by standardizing trading activity across the markets.

FINRA also works to educate investors about the securities markets and give them the tools they need to invest knowledgeably and safely. More than 13 years ago, FINRA established the FINRA Investor Education Foundation to support innovative research and educational projects aimed at improving the financial capability of all Americans. Together with the Foundation, FINRA is committed to providing investors with the information they need to better understand the markets and basic principles of investing.

These and other programs we operate—from comprehensive trade reporting to detailed public disclosure systems to licensing examinations—advance our mission by protecting investors and preserving market integrity. And they do so in many ways, from promoting compliance with applicable rules, to creating a level playing field for market participants, to stopping bad actors, to enhancing transparency and access to information.

SROs like FINRA and the securities exchanges have always been a cornerstone of the federal securities laws. Even before those laws were enacted, securities exchanges regulated their members. In 1934, Congress codified and strengthened the governance requirements that applied to the exchanges when it created the SEC. In 1938, Congress passed the Maloney Act, which extended the SRO model to broker-dealers that trade in the over-the-counter market. Congress stated then that reliance only upon direct regulation by the SEC “would involve a pronounced expansion of [the SEC’s] organization . . . [and] a large increase in the expenditure of public funds . . .”¹ One of FINRA’s predecessor organizations, the National Association of Securities Dealers (NASD), became a registered SRO as a result of the Maloney Act. In 1975, Congress again concluded that the SRO model “should be preserved and strengthened” as it amended the federal securities laws concerning the SEC’s oversight responsibilities.²

As an SRO, FINRA can involve its member firms more directly in its deliberations and thus benefit from their expertise on relevant matters, such as the different business models of those member firms and how they operate in practice, the complex and rapidly evolving securities markets in which they trade, and the wide range of investors they serve. Like other SROs, FINRA can use what it learns from its members to enrich our regulatory programs and develop solutions that are more practical, tailored, and effective than what could be developed without such input. FINRA also has flexibility to direct resources to large, multi-year technology development efforts that can improve the efficiency and effectiveness of regulatory programs. FINRA provides these benefits without any cost to taxpayers, since we are funded by fees assessed on regulated entities, among other sources.

¹ S. Rep. No. 1455, 75th Cong., 3d Sess. I.B.4. (1938); H.R. Rep. No. 2307, 75th Cong., 3d Sess. I.B.4. (1938) (duplicate text quoted in both reports).

² S. Rep. No. 94-75, 94th Cong., 1st Sess. 7, II (1975).

A critical feature of the SRO model is oversight by the SEC of all aspects of an SRO's regulatory operations. Under the federal securities laws, FINRA is subject to comprehensive SEC oversight with respect to our rulemaking, examinations, enforcement activities, and other programs. For example, the SEC:

- approves or disapproves FINRA rulemakings after seeking public comment on FINRA proposals through notice in the Federal Register;
- can abrogate, add to, and delete FINRA rules as it deems necessary or appropriate in furtherance of the purposes of the Securities Exchange Act of 1934;
- hears appeals of FINRA disciplinary actions, which also may be appealed to the federal courts;
- requires FINRA to keep records and file reports with the SEC; and
- inspects FINRA regulatory programs regularly to ensure that FINRA is fulfilling its regulatory responsibilities and to mandate corrective action as needed.

While the SEC has always supervised FINRA, in October 2016, the SEC's Office of Compliance Inspections and Examinations (OCIE) launched the FINRA and Securities Industry Oversight (FSIO) office to further enhance its program. FSIO is composed of approximately 45 staff members whose primary responsibility is the oversight of FINRA. This oversight includes comprehensive reviews of FINRA operations through inspections and examinations. Since January 2016, OCIE and now FSIO have initiated 24 inspections of FINRA programs. In addition to these programmatic and thematic inspections, they have initiated 39 targeted reviews of FINRA examination files. FSIO also holds regular monitoring meetings with senior management from FINRA offices, and receives extensive reports and documentation from FINRA on an ongoing basis.

We welcome this oversight by the SEC as we believe it not only helps us further our investor protection and market integrity mission, but also provides valuable independent perspectives on our operations. This oversight also helps to maintain and update as appropriate the self-regulatory model for FINRA as envisioned by Congress in the Maloney Act.

FINRA has a Board of Governors (Board) composed of a majority of public governors, along with industry representatives from various sectors of the business. The Board and its various committees (which include Audit, Finance, Regulatory Policy, and other key committees) play an active role in reviewing any significant initiatives at FINRA as well as the day-to-day operations of the organization. This structure, together with extensive SEC oversight, ensures that FINRA acts in the public interest while being informed by a strong understanding of broker-dealer operations and market developments.

FINRA currently has 16 standing advisory committees, 15 ad hoc committees, and 11 district committees, reflecting subject-matter expertise from the broker-dealer industry while also incorporating other perspectives, such as those of academics and investor advocates. FINRA staff generally discusses regulatory initiatives, industry issues, and

significant rule proposals with relevant committees early in the rulemaking process. This approach typically includes discussion of the reasons for proposing the rule change, the committees' views on any potential advantages or disadvantages of the rule change, the practical consequences of the rule change, and possible alternatives to the rule change that might achieve the same objectives.

FINRA also seeks to engage its member firms, investors, and other stakeholders through a variety of other formal and informal mechanisms, including the rulemaking comment process, member surveys, investor education forums, roundtables, and continuing education programs.

FINRA360

As I noted above, this summer marks an important milestone in FINRA's history as it has now been ten years since FINRA was created from the merger of the NASD and the regulatory arm of the NYSE. During this past decade, FINRA successfully integrated these two complex regulatory programs and subsequently made many substantial enhancements to its operations to adapt to changes in its membership and the markets.

Since joining FINRA, I have been focused on listening to investors, firms, and other stakeholders, reflecting our commitment to be the best-informed, most effective SRO we can be. I intend to keep up this listening tour throughout my time at FINRA. It has been inspiring to hear many express their interest in helping FINRA be a successful SRO. But the feedback—particularly the potential opportunities for improvement that have been identified—also has underscored the timeliness of stepping back and engaging in a top-to-bottom review.

FINRA360 is a multi-year exercise focused on creating an organization that is committed to continuous improvement.³ It provides a framework for processing the internal and external feedback we continue to receive, engaging in a thoughtful analysis to determine whether there are opportunities for improvement, and making changes that will produce a more effective, more efficient FINRA. Now is an opportune time for FINRA to review how our operations are—or are not—meeting the current challenges facing the organization, and to make any changes required. As a new CEO of a ten-year-old organization, with the benefit of fresh eyes, and with the support and oversight of our Board, I am working with senior management to look at how things are done and identify ways to do them better.

With FINRA360, there are several broad principles that are being used to guide our work. Most importantly, we must remain focused on how to best fulfill our core mission—promoting investor protection and market integrity while facilitating vibrant capital markets. Potential changes must be evaluated based on the extent to which they will advance these goals.

³ See: www.finra.org/about/finra360

In addition, our thinking should consistently reflect our identity as an SRO. FINRA stands at a unique intersection of regulation and industry; our mission is investor protection and market integrity, and our task is to work with our members and other stakeholders to cultivate and deploy a deep expertise in the securities industry and enable regulation that is more effective—and more efficient—than would otherwise be possible if the government acted alone. We must continue to be mindful of the potential benefits of self-regulation and consider how best to deliver those benefits. And we must be thoughtful about what types of actions or policy decisions are more appropriately left to the government rather than SROs.

FINRA360 will take time—a comprehensive and thoughtful review of our entire organization requires no less. But we are not waiting until all of the work is complete before we implement any changes, some of which are already underway. More than a set of specific proposals, FINRA360 provides a process for carefully considered—but ambitious—changes and improvements throughout FINRA, as reflected in the varied initiatives described below.

Enforcement Restructuring

Since its creation, FINRA has maintained two distinct enforcement teams within the organization—one handling disciplinary actions related to trading-based matters found through our market surveillance and examination programs, and the other handling cases referred from other regulatory oversight divisions within FINRA. On the listening tour and in other forums, I heard that stakeholders can experience these units as two different regulators. Our internal analysis also identified this structure as a potential area for improvement to address duplicative operations and sometimes different approaches to managing our enforcement activities.

In July, after careful consideration, we announced our plan to combine our enforcement programs and named a new Director of Enforcement, bringing together these teams. In addition, the Director now reports directly to me and also sits on FINRA's Management Committee. We believe these changes will result in a more effective and efficient enforcement function that will enable us to vigorously and fairly enforce applicable rules.

Engagement and Transparency

Another example is engagement. In all of our initiatives and programs, FINRA cannot be a successful SRO without meaningful interaction with member firms, investors, and other stakeholders. It is essential that we engage in ways that are conducive to promoting our shared interest in well-informed regulation, strong compliance, and vibrant capital markets.

That is why we issued a Special Notice on Engagement earlier this year to better understand how our existing mechanisms for soliciting input from members, investors

and the public—and there are many—work and how they can be improved.⁴ Improving these mechanisms in turn will help us better collect and consider feedback on the many other areas that we are reviewing under FINRA360. The comment period for this Notice recently ended, and we are reviewing the comments received, which are publicly available on our website.

Other Recent FINRA Initiatives

Our initiatives over the last year demonstrate both the breadth of FINRA's regulatory program and how we are seeking to meet the challenges of the ever-evolving marketplace and needs of investors.

Transparency for Treasury Market Regulators

On July 10, FINRA, working closely with Treasury, the Federal Reserve, and the SEC, launched an initiative for FINRA member firms to report transactions, post-trade, in U.S. Treasury securities to FINRA's Trade Reporting and Compliance Engine, known as TRACE.⁵ This initiative provides regulators, for the first time, with regular transaction information for this important market. I understand that the successful launch of TRACE for Treasuries was featured at your fixed income market structure hearing on July 14.

By leveraging the existing TRACE system for the regulatory reporting of U.S. Treasury securities, FINRA was able to accomplish this critical regulatory objective for the largest segment of the fixed income market in an efficient and cost-effective manner. According to industry figures, there is just under \$40 trillion outstanding in fixed income debt in the U.S. as of the first quarter of 2017, compared with roughly \$30 trillion in U.S. equity market capitalization. U.S. Treasury securities account for more than a third of the fixed income markets, with a little less than \$14 trillion outstanding. Securitized products are the next largest segment, with a little more than \$10 trillion outstanding.

Expanding TRACE to cover Treasury securities and making this information available to regulators required substantial technology and market expertise, extensive collaboration with and effort by our broker-dealer members, and no taxpayer funding—a good example of the potential benefits that an SRO can bring to our regulatory structure.

Although expanding TRACE reporting for Treasury securities by FINRA members was an integral first step, additional steps are being considered to increase insight into the Treasury cash market. In October 2016, the Federal Reserve Board announced its intent to collect data from banks for secondary market transactions in U.S. Treasury securities in a manner that would complement the work of the SEC in approving FINRA's collection of these transactions from broker-dealers.

⁴ See: *Special Notice: FINRA Requests Comment on Potential Enhancements to Certain Engagement Programs*. www.finra.org/industry/special-notice-032117

⁵ See: *Regulatory Notice 16-39 (SEC Approves Rule Change to Require Reporting of Transactions in U.S. Treasury Securities to the Trade Reporting and Compliance Engine (TRACE))*. <http://www.finra.org/industry/notices/16-39>

Protections for Senior Investors

Another successful recent initiative has been FINRA's Securities Helpline for Seniors. The Helpline was launched in April 2015 so that senior investors, or individuals caring for a senior investor, can call to raise concerns about issues with brokerage accounts and investments.⁶ As we have passed the two-year anniversary of the Helpline, we have fielded more than 10,000 calls from all 50 states and from individuals ranging in age from 17 to 102 years old—the average age of callers is 70 years old. The FINRA staff has referred over 820 matters to state, federal, and foreign regulators, and made more than 146 referrals to Adult Protective Services in 16 states.

In one example, a 92-year-old woman contacted the Helpline because a registered representative traded 368 times in her four separate accounts without authorization. FINRA investigated the allegations and barred the registered representative. Upon further review of the activity, the firm offered to resolve the customer's complaint and also offered a settlement to another senior couple who experienced the same mistreatment by the representative.

Helpline calls cover a variety of financial services-related products, including variable annuities, mutual funds, and real estate investment trusts. Callers have inquired about how to review an investment account statement and access investor tools and resources (such as FINRA's BrokerCheck[®]), requested assistance with lost securities, and raised concerns of potential unsuitable recommendations, fraud, or illegal activity involving brokerage accounts and investments, as well as abuse and exploitation of seniors by persons outside of the securities industry. Many firms have taken the initiative to establish designated points of contact to work with Helpline staff to streamline the process of resolving investor issues, and we are grateful to our members for this type of collaboration on such an important issue.

To date, the Helpline has returned approximately \$4.7 million to customers due to firms proactively investigating issues raised to them by the Helpline and making customers whole when appropriate. To further support these efforts, FINRA finalized a rule earlier this year to allow broker-dealers to delay a disbursement of funds or securities if the broker-dealer suspects suspicious activity in a senior's account, subject to specified conditions. This type of pause allows the broker-dealer and FINRA to look closer at the situation to determine if there is misconduct. The rule has been approved by the SEC and will go into effect early next year.

FINRA also supports this Committee's work on the SeniorSafe Act. As our experience with the Helpline has demonstrated, there is a need for this important bill, which will help allow broker-dealers and other financial services representatives to report activity that appears suspicious and may endanger seniors and their investments. We also believe that FINRA should be added as a "covered agency" under the bill so that there is no gap

⁶ See: <http://www.finra.org/investors/highlights/finra-securities-helpline-seniors>

in the ability of broker-dealers to communicate with regulators. We look forward to continuing to work with Congress on this legislation.

Technology-Driven Innovation in Regulation

Technology is vital to FINRA's ability to achieve our mission of investor protection and market integrity. To build a complete, holistic picture of market trading in the United States, our market surveillance systems process 37 billion market events a day on average and generate billions of additional derived market events by standardizing trading activity across the markets. FINRA's investments in technology have vastly improved our regulatory operations and reduced our operating costs over time.

In addition, FINRA is a pioneer in the use of cloud technology which has had significant benefits for our operations and improving our ability to surveil the markets and conduct examinations. For example, the flexibility to use virtual servers depending on need means that queries that used to take hours can now be completed in minutes or seconds. Prior to our move to the cloud, it was not unusual for a FINRA analyst to set a query running that could take hours to complete depending upon its size. In the cloud, and with improved surveillance tools, in some cases a response to a query that previously took 60 minutes has been reduced to a sub-second response time.

FINRA's use of cloud technology has enabled our staff to generate more leads from the data, process more information, and supply a greater regulatory presence to the trading markets. These advances in technology allow us to aggregate data from across multiple trading venues and see trading patterns we were not able to see before in order to better protect investors. We also have begun exploring machine learning to enhance our surveillance for suspicious trading patterns. Machine learning offers the potential to provide our analysts with powerful new capabilities to sift through mountains of data to discern signs of sophisticated efforts to violate the rules and harm investors. We also are using advanced text analytics to automatically read, summarize and categorize large quantities of incoming data, automatically linking it to information we already have.

In addition, cloud technology has improved FINRA's capabilities with respect to data security and resilience. Because data is widely dispersed and encrypted in storage and in transit, it can be more secure than it would be under some traditional approaches.

Finally, FINRA's use of cloud technology has reduced operating costs. Because we only pay for what we use and we no longer need to maintain our own infrastructure, we can achieve significant savings in data storage and usage.

Innovation Outreach Initiative

FINRA is also continuing to actively consider how our rules and programs interact with technology innovations in the broader industry. Over the past few years, FINRA has engaged in active dialogue with market participants to assess the impact of FinTech-related business models and tools on investors as well as broker-dealer

operations. We have an internal advisory committee that serves as a forum to identify and prioritize FinTech topics that impact the securities industry and to coordinate appropriate regulatory approaches with key stakeholders, including other regulators. FINRA has issued reports on Distributed Ledger Technology and Digital Investment Advice, as well as Investor Alerts on virtual currencies, automated investment tools, and crowdfunding.⁷ And we have been closely monitoring other emerging areas at the intersection of new technology and financial services, such as online capital raising, compliance-related technology (RegTech), artificial intelligence, and social media sentiment investing.

In order to further develop these efforts, we recently launched the FINRA Innovation Outreach Initiative which will engage with those in the securities industry seeking to develop or use new financial technology applications and other innovations.⁸ This initiative will help FINRA better understand these innovations and how we can foster a collaborative environment for productive interactions with firms operating in this space. It may also allow us to identify areas where we could adapt our regulatory approach to take into account evolving business models and risks.

Broker-Dealer Oversight

All of these recent initiatives are examples of how FINRA has worked to enhance our core regulatory programs and ensure they are working in the most effective and efficient manner. Through these programs, FINRA provides oversight of broker-dealer operations and the securities markets in order to protect investors and maintain market integrity. We also bring enforcement actions where there are violations, develop and refine rules that further our mission, and educate investors on the opportunities and risks they may face.

Examinations

FINRA has a comprehensive examination program and regularly examines all broker-dealers who are our members to determine compliance with FINRA's rules and those of the SEC and the Municipal Securities Rulemaking Board (MSRB). During a routine examination, FINRA examines core areas of a firm's business as well as aspects of the firm that present heightened regulatory risk. Specifically, for an examination, FINRA may review a firm's books and records to see if they are current and accurate; analyze sales practices to determine whether the firm has dealt fairly with customers when making recommendations, executing orders, and charging commissions or markups and markdowns; and scrutinize a firm's anti-money laundering program, business continuity plans, and financial integrity and internal control programs. Firms also may be subject to a rigorous review for compliance with financial and operational requirements, including how they handle customer funds and securities.

⁷ See: http://www.finra.org/sites/default/files/FINRA_Blockchain_Report.pdf

⁸ See: <http://www.finra.org/newsroom/2017/finra-launches-innovation-outreach-initiative>

In 2016, FINRA conducted nearly 1,400 routine cycle examinations and over 900 branch office examinations in our oversight of member firms. We also conducted over 2,500 cause examinations, which are targeted exams that may be initiated due to complaints, tips, referrals or other specific issues.

In January 2017, FINRA issued its annual Regulatory and Examination Priorities Letter.⁹ In the letter, FINRA identified specific areas of concern that are a focus of examinations this year including high-risk brokers, the treatment of senior investors, sales practices for complex and long-term products, the management of liquidity and other financial risks, programs to mitigate cybersecurity risks, and firms' testing of their internal supervisory controls. FINRA uses a variety of methods to better identify risk and decide where, how, and with what intensity to apply our resources. We continue to enhance the exam process by applying this risk-based approach to both the frequency of exams and the areas where our examiners focus.

Compliance Tools and Resources

FINRA also focuses on identifying better ways to help firms comply with rules. In fact, a common request from the listening tour and other interactions with our members—especially smaller firms—is that we provide more tools to assist firms in achieving compliance.

For example, we recently launched a new Compliance Calendar and Vendor Directory, which are both designed to help industry participants fulfill their compliance responsibilities. The Compliance Calendar is a way for firms to keep track of not just upcoming filing requirements and other significant deadlines, but also educational opportunities. The Compliance Vendor Directory is designed to help firms more easily locate compliance-related vendors, such as compliance consultants, cybersecurity experts, and exam prep resources.

Another initiative to aid compliance is the Cross-Market Surveillance Report Card, which we launched last year. Although firms generally review trades for manipulation, abusive traders can be very good at concealing their activity by trading across multiple firms, markets, and products. These new report cards do not reflect conclusions that violations have occurred. Rather, they indicate potential problems that a firm should review.

Firms can use this information to upgrade internal controls and address any problematic areas. And there is evidence that this approach works. In April 2017—about a year after FINRA began issuing the cross-market report cards on layering—we saw an 82 percent decline in layering exceptions. We plan to expand the program to include an additional type of cross-market surveillance alert by the end of the year with a type of alert schedule to be added in the first half of 2018.

⁹ See: <http://www.finra.org/sites/default/files/2017-regulatory-and-examination-priorities-letter.pdf>

Another new compliance tool that we have committed to providing is an exam findings report. Firms can get an individual report after any FINRA exam of their own firm. But we have often heard that it would be useful to learn more about what FINRA is seeing through its examination programs more broadly. So, later this year, we will provide firms with a new report that will summarize key examination findings from across our programs, enabling them to use this information to strengthen their own control environment and address any potential deficiencies before their next exam.

Office of Fraud Detection and Market Intelligence

The Office of Fraud Detection and Market Intelligence (OFDMI), created in 2009, centralizes FINRA's review of allegations of serious fraud and significant investor harm, and serves as a central point of contact, both internally and externally, on fraud-related issues. OFDMI reviews regulatory intelligence from numerous sources, including tips, complaints and regulatory filings, to identify and expedite review of matters involving potential fraud or other serious misconduct. OFDMI's whistleblower unit offers a telephone hotline and dedicated email box for individuals to report evidence of potentially illegal or unethical activity which is evaluated carefully and escalated for further investigation.

In addition, OFDMI conducts robust cross-market surveillance for potential insider trading and fraud OFDMI also coordinates with Enforcement and other FINRA departments to aggressively pursue matters under FINRA's jurisdiction, and refers matters involving potential fraud and misconduct that are outside of FINRA's jurisdiction to the SEC or other regulators or law enforcement agencies for further investigation. Last year, OFDMI referred 785 matters to the SEC and other regulators. And through OFDMI's high risk broker program, to date we have barred approximately 300 registered representatives from the industry.

Stopping Bad Actors

One of FINRA's most important functions is to protect investors of every age from bad actors—those who seek to evade regulatory requirements and harm investors for their own personal gain. This area is a significant focus for us. A special working group of our Board and a committee of senior staff have been working to further augment our long-standing regulatory programs focused on bad actors. I recently summarized our efforts in a speech at Georgetown University,¹⁰ and bad actors were at the top of FINRA's exam priorities letter this year.

Given how challenging it can be to identify brokers prone to abuse customers, and how important it is to do everything we can to prevent them from harming investors in the last few years FINRA has initiated more targeted efforts to better identify and supervise those firms and individual brokers who may pose the greatest risk of harm to investors—or "high-risk" firms and brokers. In addition, FINRA recently established a dedicated unit focused on monitoring and examining these high-risk brokers. A key

¹⁰ See: <http://www.finra.org/newsroom/speeches/061217-protecting-investors-bad-actors>

objective of this targeted program is to ensure we are using a risk-based methodology to allocate our finite monitoring and examination resources in ways that will best protect investors.

This heightened scrutiny has had an impact. Of the firms assessed as highest risk in the last five years, more than 40 percent are no longer in the business, in many cases because of regulatory action. In other cases, close scrutiny by our examination team has caused firms to take steps to address our concerns, such as by making changes or improvements in personnel, operations, and the quality of their supervisory controls.

It is important to be clear about the challenges and limitations inherent in identifying high-risk firms and brokers. Care is required both in how we conduct the assessment and in what we do with it. FINRA does not possess a crystal ball—our assessment of brokers for oversight purposes does not always identify brokers who will cause problems in the future. In addition, the risk profile of firms and brokers will change over time. We must continually seek to update our assessments and improve our approach based on practical experience, additional information, and new analytical techniques.

Earlier this year, FINRA's Board also approved several new initiatives to further enhance our oversight of high-risk brokers. Among them is a proposed rule amendment to require brokerage firms to adopt heightened supervisory procedures for individuals while a disciplinary case is pending appeal. We also will issue a Regulatory Notice to reinforce and clarify firms' existing supervisory obligations concerning any high-risk brokers they may employ. The Board also approved several other related measures, such as a change to our sanction guidelines to enable adjudicators to consider more severe sanctions when a respondent's history includes a pattern of damaging past misconduct. This is an area of continued focus by FINRA's Board and management and we anticipate a number of additional steps in the coming months.

Registration and BrokerCheck

FINRA operates and maintains the central licensing and registration system for the U.S. securities industry and its regulators. The Central Registration Depository, CRD®, developed in concept by FINRA and the North American Securities Administrators Association (NASAA), was introduced in 1981 and established a framework of uniform registration forms, one-stop form filing and fee collection, and a single regulatory database and registration processing system to meet the requirements of all participating securities regulators. CRD automates and supports the registration, qualification, disclosure and continuing education rules and regulations of FINRA, other SROs, the SEC and state regulators. Policies governing CRD are jointly established by FINRA and NASAA under SEC oversight.

FINRA's BrokerCheck® system makes available to the general public registration, licensing and disciplinary information on nearly 1.3 million current and former securities brokers and about 21,000 firms currently or formerly registered with FINRA or a national

securities exchange.¹¹ Implemented by FINRA in 1988, BrokerCheck allows investors to check the professional background, business practices and conduct of securities firms and investment professionals, thereby helping investors make informed choices about the individuals and firms with which they conduct business.

Market Oversight

FINRA oversees and regulates its member firms' trading across the securities markets, as well as the OTC markets for equities, corporate and municipal debt instruments, and other fixed income instruments. FINRA also conducts examinations of market making and trading firms to assess compliance with FINRA trading rules and the federal securities laws.

As noted in FINRA's 2017 Regulatory and Examination Priorities Letter¹², areas of focus for this year include potentially abusive trading algorithms, cross-market and cross-product manipulation, order routing practices, best execution and disclosure and market access controls.

Cross-Market Surveillance

FINRA has a responsibility to oversee and regulate OTC trading of exchange-listed and non-exchange-listed securities, as well as trading in corporate and municipal debt instruments and other fixed income instruments. FINRA also conducts examinations of market making and trading firms to assess compliance with FINRA trading rules and the federal securities laws.

In addition, FINRA provides surveillance and other regulatory services to U.S. equity and options exchanges. FINRA has regulatory service agreements in place with 19 exchanges that operate 26 equity and options markets. As a result, working with the exchanges, FINRA's cross-market surveillance systems canvass over 99 percent of the listed-equity market and approximately 65 percent of the listed-options market.

In order to protect investors and market integrity, it is important that FINRA be able to conduct surveillance of activity across securities markets. While there is vigorous competition across equity and options markets which has benefitted investors and market participants, a by-product of this competition is more market fragmentation, which in turn raises concerns about abusive trading algorithms like layering and spoofing that purposefully spread activity across markets in an effort to avoid detection. FINRA has found that approximately 65 percent of its surveillance alerts involve activity from more than one market and that approximately 50 percent of its alerts involve activity from more than one broker-dealer. In addition, for many of our cross-market surveillance patterns all of the alerts involve more than one market. In fact, based on market activity we have seen while conducting investigations, FINRA recently enhanced one of its equity cross-market surveillance patterns to detect potential trading abuses

¹¹ See: <https://brokercheck.finra.org/>

¹² See: <http://www.finra.org/sites/default/files/2017-regulatory-and-examination-priorities-letter.pdf>

involving up to six different broker-dealers.

The Consolidated Audit Trail (CAT), mandated by the SEC, will consolidate today's audit trails and combine them into one uniform audit trail in an effort to promote more comprehensive market surveillance. As CAT data will be available to all SEC-regulated SROs and the SEC, it will be very important that, working under the leadership of the SEC, FINRA and other SROs strive to avoid both gaps that may raise risks for investors and unnecessary duplication that would be inefficient and costly to the industry. The SROs can work together to develop a regulatory environment that leverages the respective regulatory expertise of each SRO and creates a comprehensive and effective regulatory program for today's complex markets, ensuring that markets are fair and orderly and that investors are protected.

Dark Pool Volume Transparency Initiative

With well over 30 percent of total national market system (NMS) volume now being executed off of U.S. exchanges and with nearly half of that volume being executed by so called "dark pool" automated trading systems (ATS), FINRA, in consultation with the SEC, recognized the need for greater transparency regarding OTC trading venues. To that end, in June 2014, FINRA began posting weekly on its website reported volume and trade count information for all ATSs. Market participants, investors, regulators and academics are now able to see with unprecedented granularity volume information and trends regarding dark pool trading and trading on other ATSs on a security-by-security basis.

In April 2016, FINRA expanded this transparency initiative by publishing the remaining half of equity trading volume executed OTC by all firms on a security-by-security basis (*i.e.*, non-ATS volume executed by wholesale market makers, firms that internalize order flow, block positioners, and other types of trading). This provides greater transparency to the marketplace with respect to the full range of trading activity that is currently taking place off of U.S. exchanges. In addition, FINRA further expanded transparency for OTC volume by publishing detailed ATS block trading volume information in October 2016.

Enforcement

One of FINRA's key functions is the enforcement of FINRA rules, MSRB rules, and federal securities laws and rules. FINRA may initiate investigations from various sources, including examination findings, filings made with FINRA, customer complaints, calls to the Senior Helpline, anonymous tips, surveillance reports, referrals from other regulators or other FINRA departments, and press reports. FINRA's Department of Enforcement consists of more than 300 staff members, largely experienced attorneys and investigators. For example, many of our attorneys have a broad range of experience as former federal and state prosecutors, and partners and senior attorneys at major law firms. Our investigators include former FBI agents and former industry professionals such as former traders, investment bankers, and compliance officers.

Enforcement team members investigate potential violations of FINRA rules and federal securities laws by requesting documents and testimony from registered entities. They may also work with harmed customers to collect evidence of wrongdoing in order to bring disciplinary action against their brokers. After Enforcement determines that it has evidence of a rule violation, it brings a disciplinary action to sanction the individual or firm that committed the infraction. In 2016 alone, we brought 1,434 disciplinary actions. Most of these cases settle, but when no settlement can be reached, Enforcement litigates its claims against the respondent in FINRA's disciplinary forum. Respondents have the right to appeal adverse decisions to the SEC.

Some of Enforcement's most important actions involve individual brokers who have harmed investors and in some cases posed a risk to the broader marketplace. In 2016, we barred 517 individuals for egregious violations of the securities laws and FINRA rules, such as fraud and conversion. In addition, we imposed 727 suspensions on individuals for violations that were less egregious but still serious, such as recommending unsuitable securities, falsifying customer signatures, or failing to make required disclosures. This year through July, Enforcement has barred 288 registered representatives for egregious misconduct, including 25 brokers that were designated as high risk brokers by OFDMI.

We also suspended or expelled 50 firms from the industry in 2016. These cases concerned a wide range of trading and sales practice issues. FINRA permanently expelled firms from the industry for egregious violations such as fraud, conversion, and failure to provide FINRA the information it requested to investigate potential misconduct.

FINRA also sanctioned firms by assessing fines where firms had violated the securities laws or rules; for example, in 2016 FINRA imposed significant fines for misconduct such as firms' failure to implement systems to monitor trading for suspicious transactions; failure to supervise registered representatives who recommended certain types of variable annuities, ETFs, and other complex products; failure to maintain records in a format that could not be altered; and failure to review the quality of the trade executions provided to customers.

Equally important, in the last two years (not including 2017), we have ordered some \$123 million in restitution to harmed investors. FINRA ordered \$27.9 million in restitution to customers in 2016, in line with the 5-year range of restitution, which has varied from a low of \$9.5 million in 2013 to a high of \$96.2 million in 2015. For example, FINRA has taken action against firms that failed to ensure that customers such as charitable organizations and retirement accounts were getting the sales discounts they were entitled to—we have ordered more than \$75 million in restitution to those customers over the past several years.

FINRA will continue to pursue vigorously those cases that involve harm to investors and work to remove the individuals who engage in this conduct from the industry whenever appropriate.

Rulemaking

FINRA's rulemaking process is a key point of engagement and is intended to ensure that our regulatory program is calibrated to achieve its objectives efficiently, without undue burdens on legitimate business activities. This open process makes for better rulemaking. In addition to the advisory committee consultations described above, our rulemaking process typically includes multiple opportunities for any interested parties to comment. FINRA itself provides forums for comment when it is considering a rule proposal, and all FINRA proposed rule changes must be filed with, and with limited exceptions, approved by the SEC. The SEC review process includes its own, separate opportunity for comments. FINRA rule proposals frequently are revised throughout this review process.

We also must carefully assess the impact of our rulemakings for potential impacts on stakeholders, including investors and the firms we supervise. FINRA's Office of the Chief Economist conducts an economic impact analysis on all significant rulemakings, which evaluates the proposal against the identified problem. The analysis reviews relative costs and benefits, potential impacts on FINRA member firms, and the regulatory alternatives that were considered. Particular attention is paid to the potential impact on smaller firms. The analysis can be quantitative and qualitative and is informed by consultation with the public and FINRA's advisory committees, including FINRA's Economic Advisory Committee, which is composed of leading experts from the academic and industry research communities.

Capital Formation and Rule Modernization

As we take a fresh look at our operations, we also are looking at our rulebook to identify opportunities for improvement and to ensure that we are appropriately accounting for changes in the regulatory environment and market practices. Earlier this year, for example, we issued a formal request for comment on all of our rules, operations, and administrative processes related to capital-raising and how they might impact capital formation.¹³

A vibrant capital-raising process supports both large and small businesses, creates jobs, strengthens the economy and serves the interests of investors. Broker-dealers perform an important role in capital raising, but the process is evolving and it is essential that our supervision also evolves where appropriate to ensure that important investor protections are preserved without needlessly interfering with capital formation. There have been significant developments recently in the mechanisms companies use to raise capital through securities offerings, including new rules and regulations regarding crowdfunding, exempt offerings under Regulation A, and private offerings under Regulation D.

¹³ See: *Regulatory Notice 17-14 (FINRA Requests Comment on FINRA Rules Impacting Capital Formation)*.
<http://www.finra.org/industry/notices/17-14>

FINRA has taken a number of steps in recent years to modernize its regulation of members' participation in capital-raising activities. For instance, FINRA recently created the Capital Acquisition Broker (CAB) rule set, which allows members engaged in a limited range of corporate-financing activities—such as advising companies and private equity funds on capital raising and corporate restructuring—to elect to be governed by a targeted set of rules¹⁴. In response to crowdfunding provisions of the JOBS Act, FINRA created the Funding Portal rules, which are a set of streamlined rules that are tailored to the limited scope of activities in which funding portals are permitted to engage under the JOBS Act and the SEC's Regulation Crowdfunding.¹⁵

In addition, in the last few years FINRA amended its rule¹⁶ covering new issue allocations and distributions to create an important exception to facilitate firm compliance when allocating shares of a new issue to the accounts of unaffiliated private funds. FINRA also consolidated a number of rules regarding the sale of securities in fixed price offerings, creating a simplified rule that removed numerous outdated and redundant requirements, while at the same time maintaining core protections for investors and for the integrity of such offerings.

We have also sought to update our rules on broker registration to reflect feedback about how those rules have operated over time as markets and firms have changed. Recently, the SEC approved our proposed rule change that will make it easier for an individual with no prior securities industry experience—whether an investor, a recent college graduate, or a professional seeking a second career—to take a general knowledge exam as an important first step to entering the industry. The rule change also modernizes our registration rules in other respects, and it reflects yet another effort to revisit our existing rules and determine how best to modernize them in a way that will both preserve important investor protections and reduce unnecessary burdens.

Retrospective Rule Review

Reviewing our rules and how we implement them is part of the FINRA360 goal of continual self-improvement. Changes in the industry and markets can affect whether a rule continues to achieve its original objective as well as the burdens it imposes on firms or investors. Regular rule reviews can help us understand whether rules can be made more effective and less burdensome, and also identify gaps and areas where investor protections can be strengthened.

In 2014, FINRA commenced a retrospective rule review process,¹⁷ whereby FINRA regularly looks back at significant rulemakings to make our rules more efficient without

¹⁴ See: *Regulatory Notice 16-37 (SEC Approves FINRA's Capital Acquisition Broker (CAB) Rules)*.
<http://www.finra.org/industry/notices/16-37>

¹⁵ See: *Regulatory Notice 16-06 (SEC Approval of FINRA Funding Portal Rules and Related Forms)*.
<http://www.finra.org/industry/notices/16-06>

¹⁶ See: *Regulatory Notice 13-43 (SEC Approves a Limited Exception From FINRA Rule 5131(b) to Permit Firms to Rely Upon a Written Representation From Certain Unaffiliated Private Funds)*.
<http://www.finra.org/industry/notices/13-43>

¹⁷ See: <http://www.finra.org/newsroom/2014/finra-launches-retrospective-rule-review>

diminishing investor protections. Based on these reviews, FINRA takes steps to maintain or improve the effectiveness of the rules while minimizing any negative economic impacts. The reviews consider not only the substance of the rules, but also FINRA's administration of them, and the review process also incorporates extensive engagement with the industry, investors, and other stakeholders.

These retrospective reviews can result in significant changes. For example, as part of the review of the rule set regarding communications of FINRA members with the public, we established a new public communications advisory committee, issued additional guidance, and obtained SEC approval of rule amendments to streamline or eliminate some filing and disclosure requirements.

Most recently, we launched a new review of our rules regarding outside business activities and private securities transactions, an area where we have received considerable feedback from our members and other stakeholders. It had been some time since we issued guidance on these rules, and we continue to look for public feedback on their operation.

Dispute Resolution

FINRA administers a dispute resolution forum for investors and brokerage firms and their registered employees. FINRA's Dispute Resolution program provides investors and markets with a fair, efficient and economical alternative to court actions, which are sometimes cost-prohibitive for investors with small claims. FINRA offers both mediation and arbitration services.

Since 2011, FINRA's program has provided investors the opportunity to select arbitration panels composed exclusively of public arbitrators. The all-public panel option ensures that no investor will have an arbitrator affiliated with the securities industry unless he or she voluntarily chooses one. In addition, several recent rule amendments have narrowed the definition of a public arbitrator, including by establishing a bright line test that prevents anyone who has ever worked in the financial industry from serving as a public arbitrator.

FINRA's program has several other features that distinguish it from other private arbitration forums. FINRA's program charges significantly lower arbitration fees to investors than other forums, uses an investor-friendly discovery guide, and offers 71 hearing locations, including at least one in every state. Our Motion to Dismiss Rule ensures that investors in arbitration have a full opportunity to argue their case by limiting motions made prior to the investor resting his or her case, and provides for sanctions for frivolous motions and abusive motion practices. FINRA has the authority to suspend firms and registered representatives that fail to pay arbitration awards or agreed-upon settlements.

In July 2014, FINRA formed a Task Force to consider possible enhancements to its program to improve the effectiveness, transparency, impartiality and efficiency of

FINRA's dispute resolution forum for all participants.¹⁸ In December 2015, the FINRA Dispute Resolution Task Force (Task Force) issued its Final Report relating to its review of FINRA's dispute resolution forum, which included 51 recommendations. FINRA has already taken action on the majority of the recommendations. FINRA continues to work with the National Arbitration and Mediation Committee (NAMC), a FINRA advisory committee, to evaluate ways to implement recommendations not yet addressed, and is considering additional steps to further enhance the forum's operations and transparency in response to the recommendations.

FINRA Foundation and Investor Education

In 2003, FINRA established the FINRA Investor Education Foundation,¹⁹ which aims to provide underserved Americans with the knowledge, skills and tools necessary for financial success throughout life. The FINRA Foundation accomplishes its mission through educational programs and research that help consumers achieve their financial goals in a complex and dynamic world.

Investor Protection Campaign

The FINRA Foundation's research-based Investor Protection Campaign (IPC) aims to help investors recognize that anyone with savings could be a target for those who would commit fraud. The IPC identifies the common persuasion techniques fraudsters use and encourages all investors to ask questions and check information. In collaboration with the AARP Foundation, the Association of Retired Americans, the Council of Better Business Bureaus, the National Center for Victims of Crime, the National Telemarketing Victim Call Center, the National White Collar Crime Center, state and federal securities regulators and many others, the FINRA Foundation alerts investors to the red flags of investment fraud—including the persuasion tactics fraudsters use—and empowers people to become fraud fighters.

A sampling of recent IPC accomplishments includes the following:

- From 2012–2017, the campaign has enabled more than 908,000 vulnerable investors to be counseled by FINRA Foundation-supported fraud fighter call centers.
- More than 2,100 law enforcement professionals and victim advocates have been trained by the Foundation to detect, prevent and respond to financial fraud.
- FINRA Foundation staff collaborated with researchers from the U.S. Department of Justice (DOJ) and the Stanford University Center on Longevity to prepare a financial fraud supplement to the National Crime Victimization Survey. DOJ anticipates 79,000 responses to the supplement in 2017.

¹⁸ See: <http://www.finra.org/newsroom/2014/finra-announces-arbitration-task-force>

¹⁹ See: <https://www.finrafoundation.org/>

Investor Education

Investor education is a potent form of investor protection, and FINRA's Office of Investor Education²⁰ engages with the public through a wide array of retail investor education initiatives that provide free, unbiased information and tools to help people protect themselves and better understand the markets and basic principles of investing. For example, FINRA develops and maintains interactive tools and calculators like the Fund Analyzer and Required Minimum Distribution Calculator; publishes alerts, articles and newsletters through the Investors section of FINRA's website; syndicates relevant information on topics of interest for investors through FINRA's Alert Investor blog; and creates and disseminates podcasts, infographics and videos on personal finance and investing topics such as choosing a financial professional, understanding complex investment products, dealing with the financial impact of job loss and more.

FINRA organizes or participates in dozens of investor education events each year, reaching thousands of retail investors. In addition, FINRA prints and distributes more than half a million pieces of educational material—all at no cost to the individual investors, financial educators and coaches, librarians, teachers, industry professionals and others who request them.

The FINRA Foundation's National Financial Capability Study, for example, benchmarks and tracks over time key indicators of financial capability—both nationally and state-by-state—and evaluates how these indicators vary with underlying demographic, behavioral, attitudinal and financial literacy characteristics. Separately, the FINRA Foundation supports the work of academics and other researchers who explore investor behavior.

The FINRA Foundation's projects range from helping investors spot, avoid and handle the aftermath of financial fraud to fostering the financial readiness of military families to advancing workplace financial capability programs for America's low-income workers. The FINRA Foundation also trains financial educators and equips grass-roots organizations, including a nationwide network of reference librarians, to help families in diverse circumstances.

Since its inception, the FINRA Foundation has dedicated more than \$108 million to financial capability and fraud prevention initiatives. Much of this work has been accomplished in partnership with organizations that share a deep commitment to the Foundation's mission.

Conclusion

FINRA is in the middle of a process of self-assessment and organizational improvement that will result in potentially transformational change. However, as we continue this exciting exercise, we will remain firmly focused on our core mission of protecting investors and market integrity while promoting vibrant capital markets. I look forward to

²⁰ See: <http://www.finra.org/investors>

working with Congress, other regulators, market participants, and the public to further these important goals.

