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U.S. House of Representatives
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Chairwoman Waters, Ranking Member McHenry and Members of the Committee:

Introduction

On behalf of the Financial Industry Regulatory Authority, or FINRA, I want to thank you for the opportunity to appear today to discuss the important role that our organization plays in the regulation of broker-dealers and to share our response to the January market events related to trading in GameStop and certain other stocks. We commend the Committee's review of those events, as they have raised important – and in some cases, novel – investor protection concerns that warrant thorough investigation and careful study.

Background

FINRA's mission is to protect investors and promote market integrity. FINRA is a not-for-profit, self-regulatory organization (SRO) responsible for regulating its member broker-dealers and their associated persons pursuant to the Securities Exchange Act of 1934 (Exchange Act). FINRA supports the Securities and Exchange Commission (SEC or Commission) in overseeing one subset of the securities industry – more than 3,400 registered broker-dealers and more than 600,000 registered individuals. FINRA fulfills its mission by, among other things, adopting rules that supplement those of the SEC, examining its member firms for compliance with FINRA and SEC rules applicable to broker-dealers, surveilling trading in the securities markets and enforcing member firm compliance where necessary. All FINRA activities are subject to comprehensive SEC examination and oversight; FINRA's rules must be filed with the SEC, published for public comment and (with limited exceptions) approved by the SEC.

FINRA's jurisdiction under the Exchange Act is generally limited to most broker-dealers and their personnel. We do not have jurisdiction over other financial intermediaries or market participants.¹ However, we work collaboratively with our fellow regulators that oversee the activities of those market participants, including the Commission, the Federal Reserve Board, the Commodity Futures Trading Commission, state regulators and other SROs. This collaboration includes, where appropriate, sharing data and information obtained from our extensive market surveillance and investigative activities.

¹ For example, we do not have jurisdiction over investment advisers, hedge funds, banks or other financial services providers, unless such entities are also registered as broker-dealers and members of FINRA.

For the broker-dealer activity within FINRA’s oversight responsibility, we administer comprehensive regulatory programs that complement the SEC’s oversight. These include testing and registration, surveillance, risk monitoring, examination and enforcement programs that enable FINRA to identify and remediate conduct that poses risks to investors or undermines confidence in our markets. Before discussing the recent market events, it is helpful to understand the tools available to FINRA to investigate and respond to such incidents.

Surveillance

FINRA oversees the trading activities of our member firms in the equities and options markets, and provides surveillance and other regulatory services to registered securities exchanges. FINRA’s surveillance programs assess the handling and execution of customer orders for compliance with best execution obligations and other SEC and FINRA market rules designed to protect customers. FINRA also deploys sophisticated automated surveillance programs to identify trading patterns and activity that may indicate insider trading, market manipulation and other types of fraud or abuse. Further to those ends, FINRA’s surveillance teams also conduct regular monitoring of social media platforms² related to market events to help uncover potential fraud or manipulation perpetrated through the use of false or misleading claims.

Risk Monitoring and Examinations

FINRA uses a detailed risk assessment program to inform how to monitor each member broker-dealer for potential risks to investors and markets. Informed by these assessments, FINRA examines each member firm regularly to assess its supervisory policies and procedures for compliance with applicable rules. In addition to routine firm examinations, FINRA also conducts “for cause” examinations – additional investigations and reviews triggered by specific allegations or events, including customer complaints, tips or arbitrations.

FINRA publishes a report annually that highlights some of its key risk monitoring activities and examination priorities. As described further below, the 2021 version of the report highlights our focus on, among other topics, the risks associated with app-based platforms with interactive “game-like” features that are intended to influence customer behavior. The report also discusses FINRA’s ongoing targeted review of firms with a zero-commission model, including the potential impact on compliance with such firms’ best execution obligations.³

² While we monitor social media activity, we note that FINRA does not have jurisdiction over individuals who trade in the securities markets or participate on social media platforms unless those individuals are associated with a FINRA member firm.

³ See 2021 Report on FINRA’s Examination and Risk Monitoring Program at pp. 22 and 32. <https://www.finra.org/sites/default/files/2021-02/2021-report-finras-examination-risk-monitoring-program.pdf>

Enforcement

Based on these risk monitoring, examination and surveillance activities, as well as other sources of information, FINRA investigates and takes disciplinary actions against firms and individuals as appropriate. FINRA can impose fines and suspensions, and in cases of serious misconduct, expel firms from FINRA membership and bar individuals from association with a FINRA member firm. Whenever possible, FINRA orders firms and individuals to make restitution to harmed customers. When we encounter potential violations that involve persons beyond FINRA's jurisdiction or that are linked to an existing matter at the SEC or other regulatory authorities, we will refer those matters to those authorities.

Investor Education

FINRA also works to protect investors in other ways. FINRA and the FINRA Investor Education Foundation provide free, unbiased information and tools to help retail investors protect themselves and better understand basic principles of investing and the markets. These resources include a mutual fund analyzer that allows investors to compare the impact of fees, expenses and discounts on fund values,⁴ and a series of online micro-courses,⁵ optimized for mobile technology, that cover essential topics for new investors – from setting investment goals to understanding risk and return. In addition, FINRA regularly issues investor alerts and articles that explain, in plain language, emerging products, popular strategies and current market trends. Recent publications have tackled such topics as meme investing, microcap stocks, short interest, special purpose acquisition companies (SPACs) and options trading.⁶

The Foundation also undertakes or sponsors research to better understand investor behavior, attitudes, knowledge and preferences. For example, a recent collaboration⁷ with the National Opinion Research Center (NORC) at the University of Chicago revealed useful insights about new investors during the COVID-19 pandemic and their interaction with mobile apps. In addition, as part of an ongoing National Financial Capability Study, the Foundation conducts a

⁴ Available at: https://tools.finra.org/fund_analyzer/.

⁵ FINRA, *Follow a Course to Smart Investing* (available at <https://www.finra.org/investors/learn-to-invest/smart-investing-courses>).

⁶ See, e.g., FINRA Investor Alert, *Following the Crowd, Investing and Social Media* (Jan. 29, 2021) (available at <https://www.finra.org/investors/alerts/following-crowd-investing-and-social-media>). FINRA Investor Insights articles are available at <https://www.finra.org/investors/insights>.

⁷ FINRA Investor Education Foundation & NORC, *Investing 2020: New Accounts and the People Who Opened Them* (Feb. 2021) (available at https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf). Additional issue briefs prepared as part of this research collaboration are available at <https://finrafoundation.org/knowledge-we-gain-share/consumer-insights-money-investing>.

triennial survey of U.S. adults who own investments outside of retirement accounts.⁸ This in-depth exploration of investors yields rich data on the types of products, strategies and platforms that investors use, as well as their behaviors, beliefs, attitudes and knowledge – all of which can be analyzed by different demographic variables. The Foundation intends to conduct more research on new investors in light of the changing nature of trading markets. We would be happy to share this research, as well as other Foundation research, with this Committee.

The January Market Events

Over the course of a few weeks during January, the market witnessed extreme swings in the price of GameStop stock and a sudden surge in the trading volume of this stock and options on it. For example, on January 28 alone, GameStop stock traded in a range of \$112 to \$483 per share. Short sale volume in GameStop also increased substantially during this time. This trading activity coincided with significant interest in GameStop among participants in social media discussions – including on Reddit’s “wallstreetbets” subchannel. A limited number of other stocks featured in social media discussions also experienced wide swings in prices and increases in trading volume during this time.⁹

In this context, some broker-dealers restricted trading in these securities on a short-term basis. Those trading restrictions led to confusion and frustration among some investors and created questions about the fairness of the markets. The January events also focused attention on the growth among retail investors of popular new trading platforms and services, including those offering zero-commission trades and trading in fractional shares. In addition, they highlighted apparent changes in investor behavior and attitudes and the influence of social media on the markets.

Although activity around the trading in GameStop and other stocks in January did not present the type of widespread volatility and disruption across the securities markets that we have seen in some other past events, it did underscore two important points. First, our markets and the environment in which they operate are dynamic and continually evolving, with market participants and others constantly innovating new technologies, methods of communication and investment products and services. These innovations can be beneficial for investors – such as by providing easier access to the markets, lower costs and a wider range of investment choices – but they can also present new and sometimes unanticipated risks for investors. Second, in light of this ongoing evolution in the markets and related changes in investor behavior, regulators must continually review the standards applicable to financial

⁸ FINRA Investor Education Foundation, National Financial Capability Study—Investor Study (available at <https://www.usfinancialcapability.org/investor-survey.php>).

⁹ GameStop stock experienced another volatile episode on February 24 and 25. Its stock price climbed 103% on February 24 and volume increased from about 7.5 million shares on February 23 to approximately 150 million shares on February 25. Although we generally refer to the “January market events” herein with special focus on GameStop, our regulatory reviews and related comments include trading during other periods and in other securities as appropriate.

intermediaries and the securities markets more generally and consider whether they should be updated to better protect investors and promote market integrity.

We understand that the SEC is conducting a comprehensive review of these recent market events and will share its findings in a published report. We look forward to reviewing the SEC's findings and to working collaboratively with the SEC and other regulators to develop and implement any appropriate responses to these events based on, and informed by, these findings.

In the meantime, FINRA is also separately investigating whether its broker-dealer members complied with existing rules in connection with these events and is actively considering whether FINRA rules or other standards should be strengthened in light of these events and other market trends. I will address some of our ongoing activities in each of these areas.

Ongoing Investigations

FINRA has an internal working group devoting significant resources to reviewing member firm conduct during recent market events to assess compliance with applicable SEC and FINRA investor protection and market integrity rules. We cannot comment on specific ongoing investigative or enforcement matters, but we can assure the Committee that we will take appropriate disciplinary or other remedial action, as warranted, if the facts indicate a violation of SEC or FINRA rules. In addition, we will coordinate our regulatory responses with the SEC based on the results of our respective investigations, and we will do so with other regulators as appropriate.

These ongoing investigations cover a range of regulatory requirements. For example, we have been reviewing the order routing practices of our member firms, including practices where payment for order flow is involved, to assess compliance with order handling and best execution requirements during the volatile market events and more generally. That review includes equities and options routing decisions and order handling by market makers. These order routing practices are also part of a continuing targeted review (commenced last year)¹⁰ of zero-commission firms, several of which rely on payment for order flow as a revenue source. We have also been examining firms for compliance with short sale requirements. In addition, we are reviewing the circumstances under which member firms imposed trading restrictions on customers and, more generally, whether retail customers received fair treatment consistent with applicable rules during the periods of extreme market volatility. Finally, we have been reviewing trade data and social media activity to identify and investigate any trading patterns that may suggest manipulative conduct.

¹⁰ FINRA's targeted examination letters on zero commissions are posted publicly on FINRA's website and available at <https://www.finra.org/rules-guidance/guidance/targeted-examination-letters>.

Our ongoing investigations and related reviews include a number of other matters as well. As noted above, where we identify potentially violative activity by persons not under our jurisdiction, we refer these matters to the SEC or other appropriate regulatory authorities.

Selected Policy Issues

As noted above, we look forward to reviewing the SEC's report on the January market events. The findings of this report will establish a foundation that will guide policymakers in determining whether and how existing rules and standards should be updated to better protect investors and promote market integrity.

For its part, FINRA is committed to adapting its regulatory programs to new broker-dealer business models and technologies and the evolving ways in which investors access the capital markets. We believe that it is important to review the effectiveness of our rules on a regular basis, and we have an established retrospective rule review program for this purpose. This program includes a comprehensive process to look back at significant rules to assess whether those rules are meeting their intended regulatory objectives by reasonably efficient means, and to identify opportunities to improve their effectiveness or efficiency.¹¹ Of course, market events such as those that occurred in January also provide an important opportunity for us to review the effectiveness of existing requirements in light of the actual experience of investors and market participants under particular circumstances of market stress.

As we review the more significant policy questions that have surfaced in the weeks following the January market events, it is important to note that many of these questions involve areas in which the Commission, rather than FINRA, has primary authority and policymaking responsibility. FINRA will provide support to the SEC in its review of these areas and will work to align FINRA's rules and oversight activities with the approach taken by the SEC. These areas include, for example: issues relating to market structure and the overall national market system, including the practice of payment for order flow and disclosure or other requirements to address the conflicts of interest that arise; short sale regulation and disclosure; the timing of the settlement of securities transactions; the standards for establishing market manipulation under the Exchange Act; broker-dealer financial responsibility requirements; and determining whether certain communications with retail investors constitute recommendations covered by the SEC's Regulation Best Interest (Reg BI).

The SEC's report will be essential to informing our collective thinking on these and other key policy issues. In the meantime, FINRA has been considering some of issues raised by the January market events in light of our ongoing oversight responsibilities and our mission of protecting investors and promoting market integrity. I would like to briefly offer some

¹¹ See e.g., *Regulatory Notice 14-14* (April - 2014) (outlining FINRA's general retrospective rule review process) available at <https://www.finra.org/rules-guidance/notices/14-14>.

perspectives on a few of the more prominent questions that have arisen and discuss some areas where we are considering whether updates to FINRA rules might be appropriate.

Payment for Order Flow and Best Execution

One issue that has drawn renewed scrutiny is the practice of payment for order flow¹² and how it may impact firms' obligations to obtain the best execution of customer orders. Whether such payments should be allowed, and how they are disclosed, are issues that the SEC has periodically reviewed since the 1980s (when the practice emerged) and addressed in the context of the broader set of market structure rules that the SEC has established.¹³

Longstanding SEC guidance holds that "a broker-dealer does not violate its best execution obligation solely because it receives payment for order flow or trades as principal with customer orders."¹⁴ However, the SEC also has stated that payment for order flow may "raise concerns about whether a firm is meeting its obligation of best execution to its customer."¹⁵ And ultimately, the SEC has stated that "a broker-dealer must not allow a payment or an inducement for order flow to interfere with its efforts to obtain best execution."¹⁶ In addition, in 2016, the SEC staff explained that with respect to this practice, "[t]o date, the Commission has pursued an approach based primarily on disclosure to address concerns about the potential conflicts of interest caused by payment-for-order-flow arrangements."¹⁷ The Commission updated its disclosure requirements in 2018, resulting in new aggregate payment-for-order-flow disclosures by broker-dealers since the requirements took effect in 2020.¹⁸

¹² See Exchange Act Rule 10b-10(b)(8) (defining "payment for order flow").

¹³ See, e.g., Memorandum to the Equity Market Structure Advisory Committee (EMSAC) from the SEC Division of Trading and Markets, Certain Issues Affecting Customers in the Current Equity Market Structure (Jan. 26, 2016), at pp. 7-8, available at <https://www.sec.gov/spotlight/equity-market-structure/issues-affecting-customers-emsac-012616.pdf> (describing the SEC's prior reviews of the practice and discussing relevant payment-for-order-flow disclosure requirements in Exchange Act Rule 10b-10 and Rules 606 and 607 of Regulation NMS).

¹⁴ See Securities Exchange Act Release No. 43590 (Nov. 17, 2000), 65 FR 75414, 75420 (Dec. 1, 2000) (Disclosure of Order Execution and Routing Practices Adopting Release); see also Securities Exchange Act Release No. 34902 (Oct. 27, 1994), 59 FR 55006, 55009 n.28 (Nov. 2, 1994) (Payment for Order Flow Adopting Release) (stating the SEC's belief "that bulk order routing based, in part, on the receipt of payment for order flow is not, in and of itself, a violation of [best execution] duties").

¹⁵ See Payment for Order Flow Adopting Release, *supra* note 14, at 55009.

¹⁶ See *id.*

¹⁷ See Division of Trading and Markets Memorandum to the EMSAC, *supra* note 13, at pg. 8.

¹⁸ See Securities Exchange Act Release No. 84528 (November 2, 2018), 83 FR 58338 (November 19, 2018) (Disclosure of Order Handling Information Adopting Release).

In applying these policies to its members within the broader national market system framework managed by the SEC, FINRA has incorporated the SEC's guidance on payment for order flow into FINRA's best execution rule. As noted earlier, the connection between payment for order flow and best execution has been a focus of our current targeted reviews of zero-commission trading.¹⁹ As FINRA examines for compliance with existing rules and guidance, FINRA looks closely at whether firms allow payment for order flow to interfere with their obligation to seek the best possible prices for the customer orders that they handle. Where member firms have not sufficiently considered whether their customers may receive better execution quality at competing markets or market makers, FINRA has charged firms with violations of the best execution rule.²⁰

Most recently, in March of this year, FINRA censured and fined a firm that did not sufficiently evaluate whether it was meeting its best execution obligations when it received payment for order flow.²¹ In another such case, FINRA censured and fined a firm for violating FINRA's best execution rule because the firm routed its customer orders to four firms from which it received payment for order flow but did not exercise reasonable diligence to ascertain whether those four firms provided the best execution quality for the trades relative to other potential execution venues.²² FINRA required the firm to retain an independent consultant to review the

¹⁹ See *supra* note 10. In addition to the targeted review currently underway on the impact of zero commissions, FINRA previously conducted targeted examinations of order routing and execution quality, beginning in 2014, and order routing conflicts, beginning in 2017. See also <https://www.finra.org/rules-guidance/guidance/targeted-exam-letters/order-routing-and-execution-quality-customer-order> and <https://www.finra.org/rules-guidance/guidance/targeted-exam-letters/order-routing-conflicts>.

²⁰ FINRA has also brought a number of actions in recent years for other violations of the best execution rule. See, e.g., Virtu Americas, LLC, Letter of Acceptance, Waiver and Consent (FINRA Case No. 2016049752801 (July 2020) (finding that the firm failed to provide best execution to customer orders received from two broker-dealer clients outside of normal trading hours); Morgan Stanley Smith Barney LLC, Letter of Acceptance, Waiver and Consent (FINRA Case No. 20120347147 (Aug. 2017) (finding best execution violations where the firm failed to use reasonable diligence to ascertain the best inter-dealer market for preferred securities and failed to buy or sell in such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions); Merrill Lynch, Pierce, Fenner & Smith Inc., Letter of Acceptance, Waiver and Consent (FINRA Case No. 20110288421 (May 2017) (finding best execution violations where the firm failed to use reasonable diligence to ascertain the best market when manually executing non-convertible preferred and over the counter securities by failing to access liquidity at superior prices within fully automated venues).

²¹ See TradeStation Securities, Inc., Letter of Acceptance, Waiver and Consent (FINRA Case No. 2014041812501) (March 2021) (also finding violations of payment for order flow disclosure obligations under SEC rules).

²² See Robinhood Financial, LLC, Letter of Acceptance, Waiver and Consent (AWC) (FINRA Case No. 2017056224001). (Dec. 2019); see also E*Trade Securities LLC, Letter of Acceptance, Waiver and Consent (FINRA Case No. 20130368815-01) (June 2016) (describing violations of FINRA's best execution rule because the firm lacked sufficient information to reasonably assess the execution quality it provided to its customers because, among other things, the firm "did not take into account the internalization model employed by the firm" and "was overly reliant on comparisons of the firm's overall execution quality with

adequacy of the firm’s policies and procedures in this area and certify that the firm had adopted all of the consultant’s recommendations. The SEC separately brought an action against the same firm regarding distinct best execution violations under federal antifraud provisions.²³

We look forward to working with the SEC to support its review of best execution and payment for order flow in light of the January events. Fair dealing with customers is a foundational element of FINRA’s rules, and we are fully supportive of efforts to consider whether additional requirements or guidance are needed to promote investor protection. FINRA also would support any SEC efforts to consider enhancements to the disclosure obligations that help support the oversight of best execution. The SEC’s 2018 disclosure requirement updates that took effect in 2020 have increased the public transparency of payment-for-order-flow-arrangements and have served to inform much of the current debate around the practice, and FINRA believes that additional updates to order routing disclosures, along with the corresponding execution quality disclosures, may further advance important policy goals.

“Gamification” and App-Based Discount Brokerage

FINRA’s communications with the public rules prohibit the use of false, exaggerated or misleading statements and require all firm communications to be fair and evenhanded with appropriate risk disclosure.²⁴ These standards apply to all types of public communications, including those in websites and apps, as well as more targeted communications that promote the products or services of a member firm.²⁵ We note that a broker-dealer’s customer interface that promotes trading activity is not only subject to FINRA’s communications rules but is also potentially subject to Reg BI, depending on the facts and circumstances.²⁶

One of the recent trends of retail trading platforms is the use of “game-like” and other features that may encourage investor behaviors that impact sound investment decisions. These features

industry and custom averages, rather than focusing on comparisons to the actual execution quality provided by the market centers to which the firm routed orders”).

²³ See In the Matter of Robinhood Financial, LLC, Securities Exchange Act Release No. 90694 (Dec. 17, 2020).

²⁴ See FINRA Rule 2210(d).

²⁵ FINRA has published guidance on the applicability of its standards to communications on mobile devices and apps. See, e.g., *Regulatory Notice 19-31* (September 2019) available at <https://www.finra.org/rules-guidance/notices/19-31>; *Regulatory Notice 17-18* (April 2017) at <https://www.finra.org/rules-guidance/notices/17-18> and *Regulatory Notice 11-39* (August 2011) at <https://www.finra.org/rules-guidance/notices/11-39>.

²⁶ The SEC’s Reg BI applies if there is a “recommendation,” and the SEC has indicated that the determination of whether there is a “recommendation” depends on the facts and circumstances of a firm’s interaction with the customer. See Securities Exchange Act Release No. 86031 (June 5, 2019), 84 FR 33318, 33335-37 (July 12, 2019) (Reg BI Release). Differences in platform design and the nature of communications may affect whether a firm provides a “recommendation” for purposes of Reg BI. In the absence of a “recommendation,” self-directed trading by retail investors does not implicate Reg BI. *Id.* at 33384.

– commonly described as “gamification” features – include a range of technologies and techniques designed to influence investor behavior, including “games” at sign-up; social networking tools; streaks with prizes, such as free stock; points, badges and leaderboards; and push notifications. The use of such techniques – which appear not just in some broker-dealers’ digital platforms but also in many other financial services and consumer-oriented businesses – are a focus of our risk monitoring and examination program. Our 2021 Report on FINRA’s Examination and Risk Monitoring Program cautioned member firms that the use of gamification features must be carefully evaluated to ensure that they meet all applicable regulatory obligations, including, for example, whether the use of a feature may constitute a “recommendation” under Reg BI.

Some of these features and platform designs may educate investors, enhance retail market participation and encourage increased savings and investment. On the other hand, they may increase risks to customers by encouraging actions misaligned with customers’ investment objectives or risk tolerance, or distract customers from the financial consequences of trading decisions in favor of winning competitions or achieving social status. FINRA has established a cross-departmental working group to assess how broker-dealers are using their trading platforms – including mobile applications, social media, other communications and customer data – to influence customers’ behavior.

Given the growing prevalence of these features, this is an area where we are evaluating whether additional rulemaking or guidance may be necessary to ensure that their use by broker-dealers is consistent with investor protection. We are considering publishing a *Regulatory Notice* seeking additional information on the use and impacts of gamification or, alternatively, supporting any SEC request for comment on these developments. In particular, we believe that it would be useful to seek additional input on: the different types of gamification features being used and their attendant benefits and risks to investors; the use of these features on zero-commission trading platforms and whether the combination of such features and the absence of transaction costs may lead investors to focus less on risks or indirect costs; and whether the existing regulatory framework adequately addresses any emerging investor protection concerns posed by gamification features. Such a request for feedback would inform the need for any additional rulemaking, guidance or investor education efforts. We look forward to further discussions with the SEC about our collective approach to these developments and how best to align our initiatives with the SEC’s regulatory framework, including the applicability of Reg BI.

Availability and Supervision of Options Accounts

Due to the enhanced risks of options trading, FINRA has specific rules around options account approvals, supervision and margin requirements. These rules are consistent with those across the options exchanges governing options accounts. Regardless of whether the account is self-directed, or if options are being recommended, the rules require members to perform due diligence on the customer and collect information to support a determination that options trading is appropriate for the customer. Based on that review, member firms may approve

accounts for only specified types of options activity – for example, requiring the purchase of puts and calls only, requiring minimum dollar amounts in accounts for particular types of options transactions, or placing dollar limitations on options transactions of various types. In addition, the rules require specific and periodic supervisory reviews of options accounts, including reviewing the compatibility of options transactions with investors’ investment objectives and with the types of transactions for which the account was approved. Almost all option spread transactions (and certain other options transactions) are required to be in a margin account and therefore also must adhere to maintenance margin requirements.

FINRA issued a *Regulatory Notice*²⁷ last month reminding members about existing requirements for options account approvals, supervision and margin requirements, including the need to tailor account approvals to the investment objectives and risk profile of each investor. The *Notice* also reminds firms that FINRA’s margin rules require firms to have procedures to review the limits and types of credit extended to all customers, to review the need for higher margin requirements for individual securities and customers and to formulate their own margin requirements.

FINRA continues to examine the role of options trading in recent market events and looks forward to reviewing the SEC’s findings in this area. Our examination program found a significant increase in options account openings since the onset of the COVID-19 pandemic, many of them at self-directed online trading platforms popular with retail investors. In addition, for some firms, payment for options order flow is a significant percentage of the routing inducements they receive – and an important source of revenue more generally – which can exacerbate concerns about the adequacy of controls around options account approvals and trading activity.

We share the concerns raised by the SEC and others that retail investors may be opening accounts to trade options and other complex leveraged products without fully appreciating the risks involved. In a statement last year,²⁸ the SEC noted that advances in technology have increased access for retail investors to “stocks, bonds and complex products from their desktops, tablets and phones” and that “self-directed retail investors are typically making investment decisions on their own accord via online trading platforms and without the assistance of a financial professional.” The SEC expressed concern that these self-directed investors “do not have the required protections that apply when they receive recommendations or advice from a broker or investment adviser, who must understand, and may explain if necessary, the characteristics and potential risks and rewards of the investment,

²⁷ See *Regulatory Notice 21-15* (April 2021) available at <https://www.finra.org/rules-guidance/notices/21-15>.

²⁸ See Joint Statement Regarding Complex Financial Products and Retail Investors, dated October 28, 2020, available at: <https://www.sec.gov/news/public-statement/clayton-blass-hinman-redfearn-complex-financial-products-2020-10-28>.

and determine that it is in the best interest of the retail investor.”²⁹ The SEC stated its commitment to evaluating complex products made available to investors and solicited comment on this topic. We welcome the opportunity to assist in that important effort. In addition, in light of the aforementioned developments regarding options trading by retail investors, we are considering whether changes to the options rules may be warranted, recognizing that any such changes would require close consultation and coordination with the SEC and the options markets that share our rules.

Obligations of Member Firms During Extreme Market Volatility

More broadly, FINRA published a *Regulatory Notice*³⁰ in March reminding member firms of their obligations during periods of extreme market volatility. The *Notice* reinforced members’ existing obligations with respect to handling customer orders, maintaining appropriate margin requirements and effectively managing their liquidity during extreme market conditions, such as those that occurred in January.

The *Notice* reminded member firms to maintain strong procedures, thoughtfully crafted in advance, to reasonably ensure that they can continue to provide investors access to the securities markets during times of extreme market volatility and maintain best execution for those investors. The *Notice* further reminded firms that the duty of best execution requires the fair, consistent and reasonable treatment of customer orders at all times, and reiterated prior guidance around disclosures that firms should make in connection with their fair dealing obligations. The *Notice* also provided guidance on sound liquidity practices that firms can use to meet their obligations to maintain reasonable funding and liquidity risk management during periods of extreme market volatility.

Other Topics

There are several other questions of regulatory policy arising from the January market events in connection with which FINRA is considering whether its rules should be updated to better support the overall approach established by the Commission. For example, the Commission has primary responsibility for establishing the rules relating to short selling – Regulation SHO – as well as the transparency around short selling and the stock lending market that supports it.³¹ FINRA rules require periodic reporting by its members of open short interest. We are considering potential enhancements to our short interest reporting rules, particularly around the frequency and content of reporting. We would also welcome the opportunity to explore

²⁹ See *Id.*

³⁰ See *Regulatory Notice 21-12* (March 2021) available at <https://www.finra.org/rules-guidance/notices/21-12>.

³¹ See <https://www.sec.gov/investor/pubs/regsho.htm>.

with the SEC the potential for greater transparency for regulators and, potentially, the public with respect to the securities lending markets.

Liquidity risk management is another area where additional regulation or guidance may be warranted. Liquidity practices have been an ongoing focus of FINRA's financial supervision programs.³² Broker-dealer financial responsibility is generally governed by the SEC's net capital and customer protection rules.³³ Given the importance of maintaining adequate liquidity during market volatility, even when it involves only a small number of stocks, we are considering whether additional requirements or guidance with respect to liquidity management by broker-dealers would be warranted in support of the SEC's overall financial responsibility regime. We would either recommend changes to SEC rules or, alternatively, could propose changes to FINRA rules. We will also work closely with the SEC to implement and ensure compliance with any changes that it makes to broker-dealers' financial responsibility requirements.

Market events also have prompted interest in shortening the settlement cycle. For example, the Depository Trust & Clearing Corporation (DTCC) issued a white paper in February setting out a two-year "roadmap" to move to a T+1 settlement cycle.³⁴ We note that shortening the settlement cycle requires the collaboration of broker-dealers and the asset management community. There are several issues for Congress, the Commission, the DTCC and the industry to consider in connection with this initiative, and FINRA looks forward to contributing to that discussion.

Conclusion

Thank you again for inviting me to testify today about these important issues.

FINRA looks forward to working with this Committee, the Commission and our fellow regulators to learn from these recent market events so that we can strengthen investor protections where necessary and ensure confidence in the markets.

³² See *Regulatory Notice 15-33* (September 2015) available at <https://www.finra.org/rules-guidance/notices/15-33> and *Regulatory Notice 10-57* (Nov. 2010) at <https://www.finra.org/rules-guidance/notices/10-57>.

³³ See Exchange Act Rules 15c3-1 and 15c3-3.

³⁴ See *Advancing to Together: Leading the Industry to Accelerated Settlement* available at: https://perspectives.dtcc.com/articles/leading-the-industry-to-accelerated-settlement?utm_source=dtcc.com&utm_medium=press-release&utm_campaign=accelerated_settlement; see also "SIFMA, ICI and DTCC Leading Effort to Shorten U.S. Securities Settlement Cycle to T+1, Collaborating with the Industry on Next Steps." Press Release, April 28, 2021 available at: <https://www.dtcc.com/news/2021/april/28/sifma-ici-and-dtcc-leading-effort-to-shorten-us-securities-settlement-cycle-to-t1>.