



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

THE CHAIR

August 22, 2016

The Honorable John Boozman  
Chairman  
Subcommittee on Financial Services and  
General Government  
United States Senate  
133 Dirksen Senate Office Building  
Washington, DC 20510

Dear Chairman Boozman:

Thank you for your letter regarding the Securities and Exchange Commission's (SEC) oversight of the Financial Industry Regulatory Authority (FINRA). FINRA plays a critical role in monitoring and regulating activities in the securities industry. In turn, the SEC operates a robust program for oversight of FINRA that has evolved over time to address changes in the markets' structure, the industry, and FINRA's operations.

The SEC oversees FINRA primarily through regular, risk-based inspections led by the Office of Compliance Inspections and Examinations (OCIE), and oversight of FINRA's rule filing process, which is coordinated by the Division of Trading and Markets. OCIE administers the SEC's nationwide examination and inspection program, including oversight of FINRA, investment advisers and investment companies, broker-dealers, the equities and options exchanges, the Municipal Securities Rulemaking Board, and the Public Company Accounting Oversight Board, as well as other regulated entities. OCIE has formal policies and procedures in place for conducting examinations and develops an annual inspection plan for FINRA based on a risk assessment process that leverages information from resources across the Commission. Below is a general overview of OCIE's inspection planning process for FINRA, including its risk assessment process, and a description of the subject areas that are often considered in OCIE's inspection planning process.

Each year, as part of OCIE's inspection planning process, OCIE uses information collected from a number of sources to conduct a risk assessment of FINRA's programs and departments, including FINRA district offices, and determine the number and scope of inspections OCIE will perform in that year. OCIE may also initiate special inspections of FINRA during the year based on tips, complaints, newly identified risk areas, or when circumstances warrant such an inspection. In addition, OCIE conducts oversight examinations of FINRA based on observations from OCIE's examinations of broker-dealers. OCIE incorporates oversight examination observations into its risk scoping of FINRA to determine which programs, departments, and/or FINRA district offices to inspect. Finally, OCIE is in the process of enhancing its FINRA oversight further as part of an internal reorganization, which will result in the creation of a specialized team dedicated to inspections of FINRA and other *FINRA-related* work.



OCIE's risk-based inspections typically cover programs and areas within FINRA's Member Regulation Department, Market Regulation Department, and the Enforcement Department, among others. OCIE's inspections also cover, among other areas, the subjects identified in Section 964 of the Dodd-Frank Act. Section 964 requires the Government Accountability Office (GAO) to evaluate the SEC's oversight of FINRA in ten substantive areas, which include governance, funding, executive compensation practices, examinations (including the expertise of examiners), arbitration services, advertising regulation, effectiveness of FINRA's rules, cooperation with state securities regulators, transparency of governance and activities, and policies on former employees. OCIE's risk-based inspections touch on many aspects of FINRA's operations, including, but not limited to, the following:

- **Funding:** The SEC does not approve FINRA's budget or its compensation packages. However, as part of its oversight of the effectiveness of FINRA's operations, some of OCIE's inspections incorporate an assessment of funding procedures, as well as whether specific program areas within FINRA, such as surveillance, training, or the examination program, are adequately resourced.
- **Arbitration:** Section 964 directs the GAO to evaluate the SEC's oversight of FINRA's arbitration program. OCIE's inspections focused on arbitrations consider a review of the wait times for investors seeking arbitration awards as a review area, among other areas identified as higher risk within FINRA's arbitration program.
- **Enforcement/AWCs:** When conducting inspections of FINRA's Enforcement program, OCIE includes a review of how FINRA enters into Letters of Acceptance, Waiver, and Consent (AWCs) with registered broker-dealers and whether the Commission's and FINRA's rules are properly enforced. As noted above, OCIE inspections are risk-based and cases reviewed as part of individual inspections are determined based on a risk assessment process. In instances where firms choose not to enter into AWCs and proceed to a hearing instead, those cases are appealable internally within FINRA and then to the Commission.

As noted above, Section 964 of the Dodd-Frank Act tasked the GAO with reviewing the SEC's oversight of FINRA every three years. To date, the GAO has conducted two such reviews, and OCIE has worked to incorporate the GAO's recommendations to improve oversight of FINRA. The Commission's Office of Inspector General (OIG) does not have the authority to conduct direct oversight of self-regulatory organizations (SROs), including FINRA; however, it does have the authority to audit the Commission's oversight of FINRA. For example, as noted in its most recent semi-annual report to Congress, the OIG initiated an audit of the SEC's process for reviewing proposed rule changes submitted by SROs. Among other things, the objective of the audit is to assess the SEC's compliance with applicable laws, regulations, policies, and procedures for reviewing SROs' proposed rule changes.<sup>1</sup>

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<sup>1</sup> OFFICE OF INSPECTOR GENERAL, SEC, SEMIANNUAL REPORT TO CONGRESS, OCT. 1, 2015 – MAR. 31, 2016, available at <https://www.sec.gov/oig/reportspubs/Semiannual-Report-to-Congress-October-1-2015-through-March-31-2016.pdf>.

In addition to OCIE's broad examination authority, the Division of Trading and Markets provides oversight of FINRA's rule filing process. Like other SROs, FINRA is required by statute to file with the SEC any proposed rule or any proposed change in, addition to, or deletion from its rules (collectively, "proposed rule changes"). The definition of what is a rule, and what must be filed as a proposed rule change, is broad. For example, an SRO, such as FINRA, must file as a proposed rule change any stated policy, practice, or interpretation of the SRO, unless the policy, practice, or interpretation is "reasonably and fairly implied" by an existing rule of the SRO or is related solely to the administration of the SRO (and is not a policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule). Generally, staff reviews each properly filed proposed rule change, which is also published for public comment. Certain types of proposed rule changes are effective on filing, as provided by statute, while others are subject to approval by the SEC before they can take effect. More specifically, for those proposed rule filings subject to approval or disapproval, the SEC, by statute, shall approve a proposed rule change of an SRO if the SEC finds that the rule change is consistent with applicable statutory requirements and the rules and regulations thereunder and shall disapprove a proposed rule change if it does not make such a finding. In addition, as part of the SEC's oversight of the SRO rule filing process, Division of Trading and Markets staff periodically meets with FINRA staff to discuss the subject matter of particular rule filings.

Thank you again for your letter. Please do not hesitate to contact me or have a member of your staff contact

if we can be of further assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "Mary Jo White". The signature is fluid and cursive, with the first name "Mary" being more prominent and the last name "White" written in a similar style.

Mary Jo White  
Chair