

Broker-Dealer Alert

A bi-monthly publication from the Accordo Team

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2017 Regulatory and Examination Priorities Letter

FINRA (Aug. 13, 2016)

The Annual Priorities Letter emphasized, among other regulatory concerns, protection for senior investors and proper controls for product suitability, liquidity risk and management practices and cybersecurity. In 2016, FINRA conducted an assessment of firms' liquidity risk, and determined that they lack adequate benchmarks and processes, are not sufficiently prepared for stress events and do not regularly conduct stress testing that is appropriate to the market condition or the firm. FINRA plans to examine the liquidity management practices of member firms to assess the suitability of funding and liquidity plans, focusing on accurate liquidity stress planning, firm-appropriate contingency plans and policies for ongoing stress testing and review. FINRA cited Regulatory Notice 15-33 *Liquidity Risk: Guidance on Liquidity Management Practices* for consideration and guidance on best practices. [Link](#)

Regulatory Notice 15-33 Guidance on Liquidity Management Practices

FINRA (Sep. 3, 2015)

In 2015, FINRA evaluated 43 firms' liquidity conditions under market stresses to better understand their readiness to react to adverse idiosyncratic or systemic market events. FINRA considered their understanding of the effects of a stress event (including both management and staff), the validity of their stress testing with consideration for mitigating actions, the existence of a liquidity plan, including operational components and ongoing testing, and the efficacy of the firm's contingent funding plan. The review determined that over 20% of the firms were insufficiently prepared to measure risk, and only 23% were well prepared with regards to contingency funding planning. FINRA, as a result of the assessment, advised firms to revisit their risk-management plans with a wide lens, and to do so on an ongoing basis. [Link](#)

Key Considerations:

▪ Understanding the Effects of a Stress Event

- ✓ Take into consideration that counterparties will also be affected by a stress period
- ✓ Include an assessment of liquidity risk in the new product approval process

▪ Measuring Liquidity Risk

- ✓ Forecast cash disbursement for variable stress cases
- ✓ Perform weekly liquidity risk calculations

▪ Planning and Implementing Processes

- ✓ Regularly conduct stress tests on the firm's business lines, resources, services and products for varying time horizons and varying levels of liquidity duress
- ✓ Update stress tests to include changes to the firm, new variables and disruptions
- ✓ Create a governance process to guide escalation
- ✓ Specify activation parameters for contingent funding plan

▪ Creating an effective Contingent Funding Plan

- ✓ Identify a committed facility, dedicated to the firm, and with no other commitments
- ✓ Do not rely on third party or uncommitted facilities to be available in an idiosyncratic stress event
- ✓ Train personnel and conduct testing of the daily computation of the firm's customer reserve fund requirement for stress scenarios
- ✓ Use FINRA approved asset class haircut assumptions for less liquid collateral
- ✓ Diversify sources of capital in the repo market
- ✓ Limit reliance on FICC's GCF facility undrawn capacity limit
- ✓ Develop tailored collateral liquidation plans based on securities groupings
- ✓ Set up a loss buffer in the firm's liquidity risk management plan