

FINRA 2020 Annual Budget Summary

Chairman and CEO Letter



William H. Heyman
Chairman



Robert W. Cook
President and
Chief Executive Officer

As we have for the past two years, we are once again publishing FINRA's Annual Budget Summary, a forward looking document designed to complement the audited Annual Financial Report (AFR) we release each year to describe our finances and operations over the prior year. This Budget Summary outlines how we plan to deploy our resources in 2020 to meet FINRA's various regulatory responsibilities and is in keeping with our Financial Guiding Principles, which are set forth in full below.

It is important to note at the outset that the 2020 budget summarized below was developed and approved by FINRA's Board of Governors before the nature and extent of the COVID-19 outbreak became apparent. That event has significantly impacted the business and operations of many of our member firms, as well as how FINRA performs many of its functions. We expect to continue to adjust our operations as appropriate to best achieve our mission as this situation evolves. These adjustments and the pandemic's impact on our member firms may have implications for our financial performance relative to the projections in the 2020 budget. The Board will continue to monitor these developments and management's response.

As a not-for-profit, self-regulatory organization whose operations are funded by industry fees, without the support of any taxpayer dollars, FINRA must prudently manage its finances to ensure it can appropriately support its mission to protect investors and promote market integrity in a manner that facilitates vibrant capital markets. The 2020 budget as adopted is broadly consistent with how we have historically managed our revenues and expenses to carry out this mission. However, as markets become more complex—and our member firms continue to adapt and innovate—so too must FINRA's approach to new regulatory challenges. To that end, our 2020 budget reflects our commitment to investing in technological enhancements and other transformational initiatives that can help FINRA stay nimble as our markets and regulatory responsibilities evolve.

As described in the Budget Summary, FINRA's 2020 operating revenues are projected to be \$868.9 million, flat compared to 2019 operating revenues. Revenue from regulatory fees—including fees that are primarily assessed according to firms' gross revenue and trading volume, and firms' total number of registered representatives—is projected to increase. Revenue from user fees is expected to remain flat; however, contract service fees are expected to decline.

Operating expenses, meanwhile, are projected to increase 2.8 percent in 2020. FINRA continues to manage expenses closely; since 2015, FINRA's expense increases have remained largely in line with inflation, at an annual rate of 1.9 percent. As described in our Financial Guiding Principles, the Board's Management Compensation Committee reviews and approves the salary structure and the annual incentive compensation pool for the organization, among other things, and each year provides a report that is included in FINRA's AFR.

We anticipate capital initiative spending, excluding one-time extraordinary initiatives discussed below, of \$74.6 million in 2020. This amount includes \$36.1 million for new initiatives. Many of these initiatives, such as the transformation of our continuing education program and a redesign of the electronic Financial and Operational Combined Uniform Single Reports (eFOCUS) filing system, are intended to improve the FINRA resources used by member firms to achieve compliance. Other initiatives are focused on improving the efficiency and effectiveness of FINRA's operations, including projects to support the ongoing transformation of our enforcement program and examination and risk monitoring programs, and to enhance how we manage regulatory cases. The remaining \$38.5 million is largely being deployed to complete initiatives already underway, such as the further implementation of machine learning in our market surveillance programs, or to support mandatory initiatives, such as those required to meet regulatory requirements.

In addition to these capital initiative costs, for 2020 FINRA has budgeted nearly \$80 million for one-time extraordinary initiatives that are anticipated to be infrequent in nature and not reflective of FINRA's annual, recurring spending on capital initiatives. These initiatives, which are generally expected to be completed or otherwise funded by the end of 2022, include the multiyear transformation of our externally facing digital platforms for member firms, including all of our firm and representative registration systems; the restructuring of our existing office space in New York by relocating certain functions to lower-cost properties; and the mandatory integration of data from the Consolidated Audit Trail (CAT) into existing FINRA surveillance patterns and applications, creation of new surveillance patterns, and development of a program to monitor industry member compliance with CAT reporting requirements.

The 2020 budget continues to reflect the intentionally conservative methodology we adopted in 2018, which assumes there are no fine monies available to support capital initiatives and extraordinary initiatives, and that there are no investment gains or losses on our financial reserves. Fine monies are excluded because we do not establish fine "targets" based on revenue considerations. Under our Financial Guiding Principles, they are accounted for separately and their use must be approved by the Board of Governors or its Finance Committee for enumerated purposes. We will publish a separate report describing the use of fine monies from 2019, as we did for 2017 and 2018.

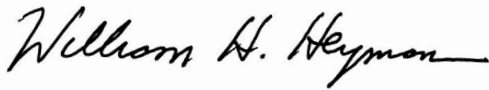
Taking into account these assumptions, we are again projecting that our expenses will exceed our operating revenues in 2020, which could result in a potential draw-down of our reserves of \$210.2 million (referred to as the Potential Reserve Reliance). As in prior years, this projection helps us understand at the beginning of the year, for budgeting purposes, how reliant we may have to be on our reserves during the course of the year. However, in practice, our actual net income or loss—to be reflected in our 2020 AFR—will ultimately include fines, investment returns and other accounting adjustments. For reference, our 2018 budget included a Potential Reserve Reliance of \$138.1 million, but we ultimately reported a GAAP net loss in our 2018 AFR of \$68.7 million. Our 2019 budget included a Potential Reserve Reliance of \$185.8 million; our 2019 GAAP net loss, which will be lower than the Potential Reserve Reliance for 2019, will be reported as usual in the 2019 AFR this summer.

Over the last several years, we have relied on our reserves to fund budget deficits instead of increasing member firm fees, with 2020 marking the seventh consecutive year we have not increased fees. As a result, FINRA has drawn down approximately \$650 million from its reserves since 2010.

While drawing down our reserves in lieu of fee increases may continue to result in net losses, this measure is part of our longer-term financial planning, which in turn reflects our Financial Guiding Principles. These plans include continuing to draw down excess reserves over the next five years (including the amount budgeted for 2020) before reaching a minimum targeted reserve level of one year of operating expenses; continuing to focus on prudent management of our expenses; and, as we have previously stated, eventually raising regulatory fees. While raising fees will be necessary, our goal is to provide member firms with sufficient advance notice in order to plan accordingly, and to phase fee increases in over multiple years. As noted above, no increase of regulatory fees is planned for 2020. We will provide further details regarding these plans in due course.

FINRA remains committed to fulfilling its mission of protecting investors and safeguarding market integrity, and to appropriately managing its finances to support that mission. We continue to welcome comments or suggestions from our member firms and other relevant stakeholders regarding our financial and transparency initiatives.

Sincerely,



William H. Heyman
Chairman



Robert W. Cook
President and Chief Executive Officer

FINRA is a not-for-profit organization dedicated to investor protection and market integrity. It regulates one critical part of the securities industry—brokerage firms doing business with the public in the United States. FINRA, overseen by the SEC, writes rules, examines for and enforces compliance with FINRA rules and federal securities laws, registers broker-dealer personnel and offers them education and training, and informs the investing public. In addition, FINRA provides surveillance and other regulatory services for equities and options markets, as well as trade reporting and other industry utilities. FINRA also administers a dispute resolution forum for investors and brokerage firms and their registered employees. For more information, visit www.finra.org.

- 1. Fund Our Mission** – As a not-for-profit organization, we target break-even cash flows that allow us to appropriately fund our mission of protecting investors and promoting market integrity while facilitating vibrant capital markets. Operating expenses are primarily funded through operating revenues. We rely on our financial reserves (discussed below) to support our mission, and draw upon the principal as needed.
- 2. Ensure Financial Transparency** – We publish an Annual Financial Report that is prepared and presented in accordance with GAAP and audited by an independent public accounting firm. We also publish a top-line annual budget that demonstrates our primary sources of income and our primary expenses for the coming year. Following each fiscal year, we provide an accounting of the approved uses of fine monies (discussed below) during that year.
- 3. Manage Expenses Responsibly** – We carefully manage expenses while ensuring that we can carry out our regulatory responsibilities effectively.
 - 3.1 Compensation Oversight** – Our employees are our most important asset. We seek to offer compensation in line with the competitive market in order to attract, develop and retain high-performing individuals who can help us achieve our mission. The Board’s Management Compensation Committee reviews and approves the salary structure and the annual incentive compensation pool for the organization, as well as the individual incentive compensation awards for the most senior executives. Each year, the Committee provides a report that is included in our Annual Financial Report. Although a variety of factors are considered when determining compensation levels for individual employees and the organization as a whole, no compensation determinations are based on fines or other sanctions imposed on the industry.
 - 3.2 Capital Initiatives Oversight** – Appropriate investments in capital initiatives to enhance our technology and regulatory capabilities are critical to our mission. These projects are non-recurring expenditures that improve the effectiveness and efficiency of our operations; they must undergo a senior management review and approval process, with projects above defined thresholds requiring special approval by the Board or its Finance, Operations and Technology Committee (Finance Committee). These projects fall into several categories:
 - **Capital Maintenance** – Necessary expenditures for items such as building/leasehold improvements or hardware/software (such as servers, storage devices or network equipment).
 - **Mandatory Initiatives** – Regulatory expectations driven by the SEC or other legal, regulatory, audit or contractual requirements; initiatives required by technology obsolescence (such as software no longer supported by vendors); and required infrastructure support (such as cybersecurity improvements).
 - **Carryover Initiatives** – Projects in one of the former categories that carry over from a prior year are evaluated for continued funding.
 - **New Initiatives/Enhancements:**
 - **Minor Enhancements** – Funding to provide capacity for minor enhancements to existing technology (*i.e.*, software improvements).
 - **New Initiatives** – Investments in new systems or technology that will improve our regulatory capabilities or services. These initiatives are assessed for their contribution to our operational efficiency and effectiveness, including their ability to provide demonstrable improvements to the quality of FINRA’s regulatory program, tangible benefits for member firm compliance, or a measurable and acceptable financial return.

4. **Maintain Reasonable Member Fee Levels** – We increase member fees only after evaluating other potential sources of funding (*including* drawing down on excess reserves) and determining that our expenses are appropriately calibrated to our regulatory responsibilities.
5. **Use Fines to Promote Compliance and Improve Markets** – When a member firm or registered representative engages in misconduct, restitution for harmed customers is our highest priority, although there are many cases in which it is not practical. We also assess whether a sanction should be imposed in order to discourage similar conduct by the firm, registered representative, or others. When we impose fines, the amounts are based on the facts and circumstances of the misconduct and the principles set forth in our Sanction Guidelines; fines are not based on revenue considerations, and we do not establish any minimum amount of fines that must be collected for purposes of our annual budget.

Fines collected are accounted for separately, and the use of these monies is subject to special governance procedures, restrictions on use and transparency requirements.

- Any use of fine monies, regardless of amount, must be separately approved by the Board or its Finance Committee. These monies are not considered in determining employee compensation and benefits.
 - The Board or Finance Committee may authorize the use of these funds for: (i) capital/initiatives or non-recurring strategic expenditures that promote more effective and efficient regulatory oversight by FINRA (including leveraging technology and data in a secure manner) or that enable improved compliance by member firms; (ii) activities to educate investors, promote compliance by member firms through education, compliance resources or similar projects, or ensure our employees are highly trained in the markets, products and businesses we regulate; (iii) capital/initiatives required by new legal, regulatory or audit requirements; or (iv) replenishing reserves (described below) in years where such reserves drop below levels reasonably appropriate to preserve FINRA's long-term ability to fund its regulatory obligations.
 - On an annual basis, we make public a description of the Board or Finance Committee-approved uses of fine monies during the prior year.
6. **Sustain Appropriate Reserves** – We rely on our financial reserves, which originally derived from the sale of Nasdaq, to support our regulatory mission. We strive to maintain an appropriate level of reserves; currently, the Board believes that level is at least one year of expenditures. Reserves are invested at the direction of the Board's Investment Committee, which provides a report that is included in our Annual Financial Report. The Board may draw upon the principal as needed, including to cover cash flow losses, defer fee increases, support FINRA's regulatory operations, enhance member firm compliance or otherwise improve markets.

The FINRA Board will review these Principles on an annual basis.

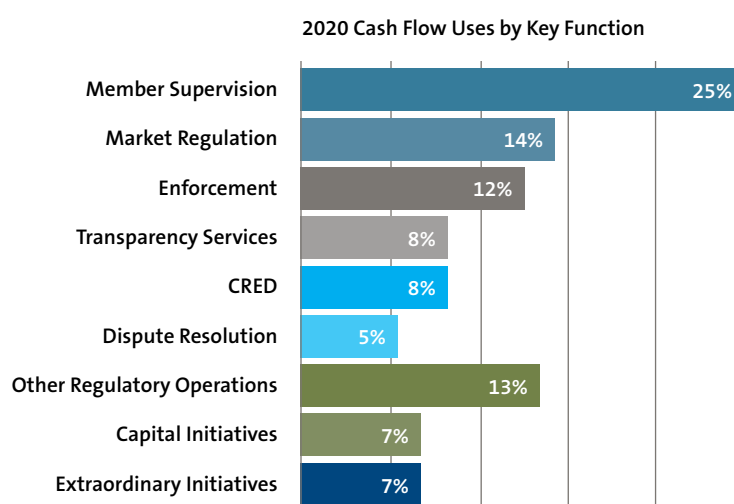
FINRA 2020 Annual Budget Summary

Budget summaries reflect management's internal reporting framework and differ from U.S. generally accepted accounting principles (GAAP). Annual budgets are subject to change during the year as circumstances arise.

Budget Trend <i>(in millions)</i>	2018 Budget ¹	2019 Budget ¹	2020 Budget
Operating Expenses	\$888.0	\$922.5	\$950.8
Capital Initiatives	\$59.0	\$60.8	\$74.6
Extraordinary Initiatives ²	\$33.1	\$70.2	\$79.1
Total Cash Flow Uses	\$980.1	\$1,053.5	\$1,104.5
Operating Revenues	\$822.0	\$846.9	\$868.9
Interest and Dividend Income	\$20.0	\$20.8	\$25.4
Potential Reserve Reliance ³	\$138.1	\$185.8	\$210.2
Total Cash Flow Sources	\$980.1	\$1,053.5	\$1,104.5

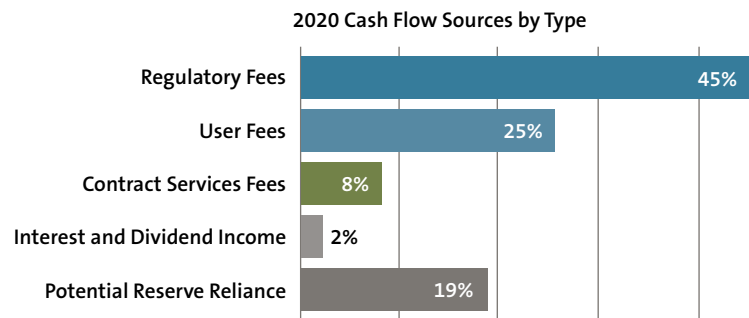
1. The budget presentation above for 2018 and 2019 has been adjusted to reflect Extraordinary Initiatives, consistent with the 2020 budget presentation.
2. Extraordinary Initiatives reflect one-time special projects that are anticipated to be infrequent in nature and not reflective of FINRA's annual, recurring spending on capital initiatives. These initiatives, which are generally expected to be completed or otherwise funded by the end of 2022, include costs for New York Building Renovations, Digital Experience Transformation, Registration Systems Transformation and CAT Integration, among other projects.
3. The Potential Reserve Reliance excludes the impact of any Board-approved use of fine monies and investment gains/losses.

Cash Flow Uses <i>(in millions)</i>	2020
Member Supervision	\$274.6
Market Regulation	\$156.9
Enforcement	\$137.2
Transparency Services	\$90.7
Credentialing, Registration, Education and Disclosure (CRED)	\$83.7
Dispute Resolution	\$59.9
Other Regulatory Operations ⁴	\$147.8
Total Operating Expenses ⁵	\$950.8
Capital Initiatives	\$74.6
Extraordinary Initiatives	\$79.1
Total Cash Flow Uses	\$1,104.5



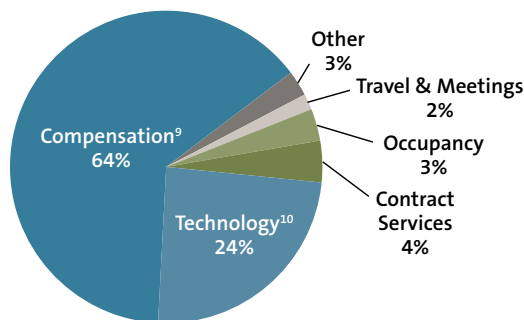
4. Other Regulatory Operations include the Office of General Counsel, Advertising Regulation, Corporate Financing, the Office of Hearing Officers, the Office of Member Relations and Education, the Office of Investor Education and other regulatory support functions.
5. Operating Expenses reflect an allocation to each key function for compensation and benefits, contract services, technology and occupancy, as well as costs attributed to other general and administrative services.

Cash Flow Sources <i>(in millions)</i>	2020
Regulatory Fees ⁶	\$495.1
User Fees ⁷	\$280.9
Contract Services Fees ⁸	\$93.0
Total Operating Revenues	\$868.9
Interest and Dividend Income	\$25.4
Potential Reserve Reliance	\$210.2
Total Cash Flow Sources	\$1,104.5

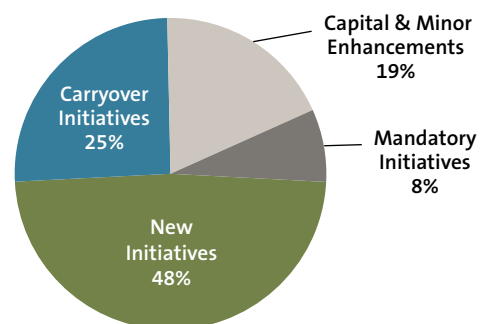


6. Regulatory Fees primarily include the Gross Income Assessment, Personnel Assessment and Trading Activity Fee.
7. User Fees primarily include Registration Fees, Transparency Services Fees, Dispute Resolution Fees, Qualification Fees, Continuing Education Fees, Corporate Financing Fees and Advertising Fees.
8. Contract Services Fees represent amounts charged for regulatory services provided primarily to markets operated by Nasdaq, NYSE, Cboe and other exchanges. These services include surveillance, investigations, examinations and disciplinary work. Contract Services Fees also include fees for the mortgage licensing system FINRA developed and maintains on behalf of the Conference of State Bank Supervisors, and fees for implementing and maintaining the Bluesheets system on behalf of the SEC. Contract Services Fees cover the cost of the services being provided.

2020 Operating Expenses



2020 Capital Initiatives by Type¹¹



9. Compensation includes only non-Technology staff.
10. Technology includes costs for Technology employees and contractors; security; and hardware, cloud hosting and software support required to maintain and operate the applications and environments that enable FINRA's regulatory activities.
11. Refer to the Financial Guiding Principles for a description of the different categories of Capital Initiatives.

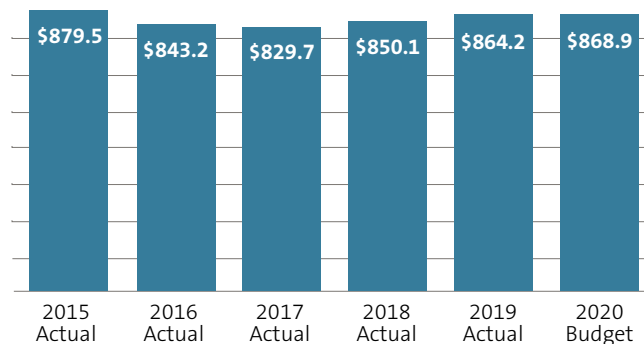
2019 Actuals are preliminary and do not reflect final year-end adjustments.

Historical Trends

Operating Revenues*

Operating revenue in 2020 is budgeted to remain flat with 2019's level. FINRA derives nearly half of its revenues from industry fees that are assessed according to firms' gross revenue and trading volume, as well as firms' total number of registered representatives. As budgeted for 2020, overall revenue generated through these fees is projected to increase due to higher firm revenues partially offset by lower trading volume. At the same time, user fees, including registration fees and testing fees, are relatively flat and contract services fees are declining. More detail is available on the next page.

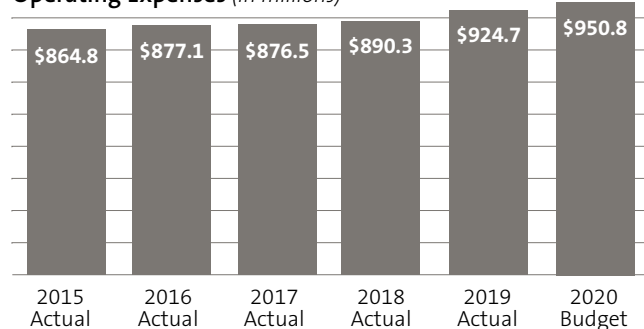
Operating Revenues (in millions)



Operating Expenses*

Operating expense increases have stayed largely in line with inflation, at an annual rate of approximately 1.9 percent since 2015. Cost-saving efforts have been driven by managing our compensation costs without compromising our regulatory responsibilities, among other organizational and process improvements. For example, we reduced incentive compensation and held senior officer salaries flat in 2016 and 2017, then held officer salaries flat again in 2018. In 2020, we took steps to help improve FINRA's long-term financial sustainability, including implementing a voluntary retirement program that will have a long-term, positive impact on our operating expenses in part by reducing our overall compensation costs. In addition, for 2018, 2019 and 2020, we identified further expense reductions; and through FINRA360, we continue to seek other efficiencies and opportunities to better leverage technology to do our work.

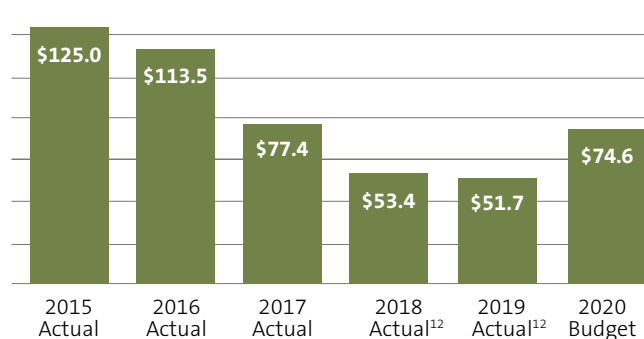
Operating Expenses (in millions)



Capital Initiatives*

Capital initiative spending varies from year to year based on the need to enhance regulatory and related technology capabilities. The increased spending in 2015 and 2016 was largely due to a decision to migrate FINRA's Market Regulation technology environment from a data center structure to a cloud-based architecture, in addition to the one-time integration of Cboe surveillance patterns and other regulatory tools into the FINRA environment as part of FINRA providing certain services to Cboe. The increased spending in 2020 is in part due to investments in new initiatives such as transformation of our examination and risk monitoring programs; enforcement program; and continuing education program.

Capital Initiatives (in millions)



* Historical results reflect internal management reporting and will differ from GAAP, which includes depreciation and other accounting adjustments.

12. Capital initiative spending for 2018 and 2019 has been adjusted to exclude Extraordinary Initiatives, consistent with the 2020 budget presentation.

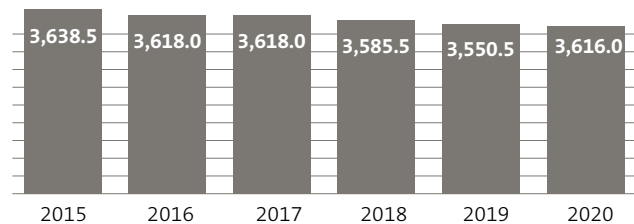
2019 Actuals are preliminary and do not reflect final year-end adjustments.

Workforce

FINRA's fluctuations in headcount since 2015 are largely attributable to changes in regulatory services provided to NYSE, Nasdaq and Cboe. In addition to managing our workforce more effectively, approximately 100 contractors and temporary employees have been converted to full-time staff in recent years.

* The headcount does not include contractors.

Headcount*



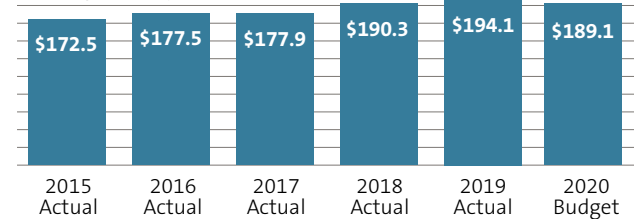
Historical Operating Revenue Trends

The following provides a five-year look back at the four fees that represent FINRA's largest sources of operating revenue.

Trading Activity Fee

The Trading Activity Fee is a transaction-based fee that is assessed monthly on firm trading activity in covered securities across all markets.

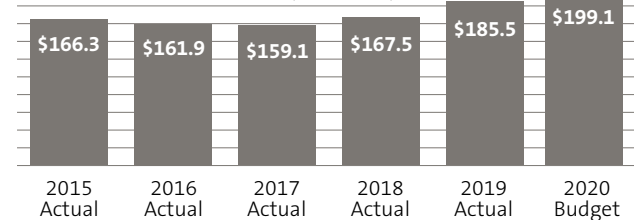
Trading Activity Fee (in millions)



Gross Income Assessment

The Gross Income Assessment is an annual fee that is assessed based on the firm's prior year's total gross revenue less commodities revenue. The assessment is based on a tiered rate structure that includes provisions that have kept it relatively flat through 2018.

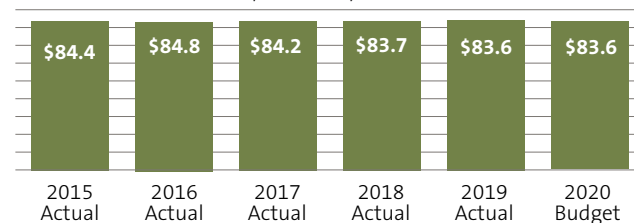
Gross Income Assessment (in millions)



Personnel Assessment

The Personnel Assessment is an annual fee that is assessed based on the firm's number of registered representatives as of December 31 of the previous year and is applied to a regressive tiered rate structure.

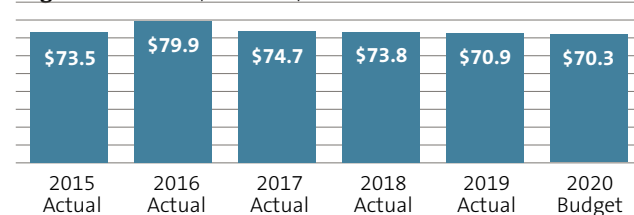
Personnel Assessment (in millions)



Registration Fees

Registration Fees include fees for various registration-related requirements for firms and registered securities representatives in the industry such as initial registration, fingerprinting, disclosures and terminations.

Registration Fees (in millions)



The 2020 budget is allocated according to the following key functions.¹³

Member Supervision

FINRA's Member Supervision Department monitors and examines for member compliance with industry rules and regulation, and works to detect and address possible fraud or other misconduct.

25%

Market Regulation

FINRA's Market Regulation Department conducts automated surveillance, examinations and investigations of trading activity in U.S. equities, options and fixed income markets.

14%

Enforcement

FINRA's Enforcement Department investigates possible misconduct and brings disciplinary actions for violations of industry rules and regulations.

12%

Transparency Services

FINRA's Transparency Services Department operates facilities that disseminate real-time and historical market information for over-the-counter (OTC) trading in the equity and fixed income markets including the Trade Reporting and Compliance Engine (TRACE) and maintains the databases FINRA uses to oversee OTC securities.

8%

Credentialing, Registration, Education and Disclosure

FINRA's Credentialing, Registration, Education and Disclosure Department operates FINRA's utilities to register and test securities industry personnel, and provides those same services under contract for the benefit of investment advisers and mortgage brokers.

8%

Dispute Resolution Services

FINRA's Dispute Resolution Services Department operates a dispute resolution forum for investors, brokerage firms and their registered employees, and administers arbitrations and mediations through a network of four regional offices, with 70 hearing locations, including one in each state and Puerto Rico.

5%

Other Initiatives

Other initiatives include capital initiative projects and onetime extraordinary initiatives. Capital initiative projects are non-recurring expenditures that improve the effectiveness and efficiency of our operations, and include costs such as the transformation of our continuing education program and a redesign of the electronic eFOCUS filing system, and the ongoing transformation of our enforcement program and examination and risk monitoring programs. Extraordinary initiatives reflect one-time special projects that are anticipated to be infrequent in nature and not reflective of FINRA's annual, recurring spending on capital initiatives, such as costs to relocate certain New York-based functions to lower-cost properties, the multi-year transformation of our externally facing digital platforms for member firms, and the mandatory integration of data from the Consolidated Audit Trail (CAT).

14%

Other Regulatory Operations

13%

FINRA's other regulatory operations include the Office of General Counsel, Advertising Regulation, Corporate Financing, the Office of Hearing Officers, the Office of Member Relations and Education, the Office of Investor Education, the Office of the Chief Economist and other regulatory support functions.

FINRA's **Office of General Counsel** assists FINRA in adopting and interpreting rules applicable to securities firms and brokers. FINRA solicits comment on its proposed rules from its members, investors and other interested parties, and, with limited exceptions, all FINRA rules must be approved by the SEC.

Advertising Regulation oversees compliance with rules intended to ensure that member communications to the public are fair, balanced and not misleading.

Corporate Financing regulates corporate offerings to address fraudulent private placements and ensure underwriting compensation is fair.

The **Office of Hearing Officers** is an office of impartial adjudicators of disciplinary cases brought by FINRA's Enforcement Department against FINRA members.

The **Office of Member Relations and Education** is responsible for maintaining and enhancing open and effective dialogue with FINRA member firms, and oversees FINRA conferences and the FINRA Institute at Georgetown Certified Regulatory and Compliance Professional program.

The **Office of Investor Education** provides investors with financial tools and resources; and through the FINRA Investor Education Foundation®, FINRA supports important research and financial education initiatives.

The **Office of the Chief Economist** conducts research and analysis in support of FINRA's rulemaking and policy agendas.

The Annual Budget Summary does not include the FINRA Investor Education Foundation and FINRA CAT, LLC. FINRA's Annual Financial Report includes the consolidated results of FINRA, the Foundation and FINRA CAT, LLC.

FINRA Investor Education Foundation

The Foundation empowers underserved Americans with the knowledge, skills and tools to make sound financial decisions throughout life. The Foundation supports innovative research and educational projects aimed at segments of the investing public that could benefit from additional resources.

FINRA CAT, LLC

FINRA CAT, LLC acts as the Plan Processor of the Consolidated Audit Trail (CAT) system, the central repository of trades, quotes and orders for all U.S. exchange-listed and over-the-counter equity securities and U.S. exchange-listed options contracts across all U.S. markets and trading venues.

13. The 2020 budget by key function represents an allocation of operating expenses for compensation and benefits, contract services, technology and occupancy, as well as costs attributed to other general and administrative services.



Investor protection. Market integrity.

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