FINRA 2021 Annual Budget Summary

Chairperson and CEO Letter

Eileen K. Murray
Chairperson

Robert W. Cook
President and
Chief Executive Officer

FINRA is once again publishing its 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 2021 to meet FINRA's various regulatory responsibilities, consistent with our Financial Guiding Principles, which are set forth in full below.

FINRA remains committed to appropriately funding its mission of protecting investors and promoting market integrity in a manner that facilitates vibrant capital markets. The 2021 budget, which was developed as part of a multi-year strategic framework designed to support that mission, was approved by the Board in December 2020 and incorporates financial projections for 2021 as of that time. The COVID-19 pandemic continues to impact how FINRA performs many of its functions, as well as the business and operations of our member firms. FINRA's 2021 budget reflects the expectation that many of the adjustments we made to our operations during 2020 (and the related financial implications experienced during this time) will continue well into 2021.

As described in the Budget Summary, FINRA's 2021 operating revenues are projected to be $924.2 million, a decrease compared to 2020 operating revenues. The COVID-19 pandemic presented a unique set of circumstances in 2020 that contributed to increased revenues due primarily to higher trading volumes and a large number of public offerings. While the budget anticipates that overall trend may continue, it projects that revenues will decline by nearly six percent in 2021 as trading volumes and filing fees from public offerings stabilize. Additionally, FINRA realized lower operating expenses than budgeted for 2020, due to vacancies created from a one-time voluntary retirement program implemented in 2020 that took more time to fill than anticipated during the pandemic, as well as significant reductions in travel and in-person testing expenses. Operating expenses are anticipated to increase in 2021 by approximately 3.5 percent over 2020 budgeted levels, with headcount gradually rising to budgeted levels and in-person testing and travel expected to pick up as the year progresses.

In addition, the budget anticipates capital initiative spending, excluding one-time Board-approved initiatives discussed below, of $65 million in 2021. We continue to invest in technology initiatives that improve the efficiency and effectiveness of FINRA's operations, and enhance our longer-term financial sustainability, including cybersecurity needs and mandatory technology enhancements.

As described in the summary, the 2021 budget includes $83.4 million for one-time, key initiatives (many of which began in prior years) that are anticipated to be infrequent in nature and not reflective of FINRA's annual, recurring capital spend on initiatives. These initiatives, which are generally expected to be completed or otherwise funded by the end of 2023, include modernizing systems that support member firm registration, filing and reporting requirements; digitalization of our Enforcement programs; compliance with Consolidated Audit Trail requirements; adjustments to our New York real estate footprint to relocate certain functions to lower-cost properties; and significantly improving FINRA's advanced analytics capabilities.

The 2021 budget presentation below 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 2020, as we have for the last three years.

In light of the projected revenues and expenses described above, the budget anticipates we will report a loss in 2021, with a potential draw-down of our reserves of about $187.5 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 2021 AFR—will ultimately include fines, investment returns and other accounting adjustments (including consolidated subsidiaries such as the FINRA Investor Education Foundation and FINRA CAT, LLC).

As a not-for-profit, self-regulatory organization whose operations are funded by industry fees, without the support of any taxpayer dollars, FINRA has developed long-term plans for financial sustainability that reflect our Financial Guiding Principles. Over the last several years, in accordance with these plans, we have relied on our reserves to fund budget deficits instead of increasing member firm fees. 2021 marks the eighth consecutive year we have not increased fees; as a result, FINRA has drawn down approximately $700 million from its reserves since 2010.

Looking forward, we have previously shared a plan that was filed with and published for comment by the U.S. Securities and Exchange Commission last year pursuant to which FINRA will continue to draw down excess reserves over the next four years before reaching a minimum targeted reserve level established by the Board, and will begin to gradually increase regulatory fees between 2022 and 2024. This delayed phase-in period for increasing fees is intended to provide time for member firms to plan accordingly and will be enabled through the continued use of our excess reserves, as described above.

FINRA remains committed to appropriately managing its finances to support our mission. We continue to welcome comments or suggestions from our member firms and other relevant stakeholders regarding our financial and transparency initiatives.

Sincerely,

Eileen K. Murray

Eileen K. Murray
Chairperson

Robert W. Cook

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President and Chief Executive Officer

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 2021 Annual Budget Summary

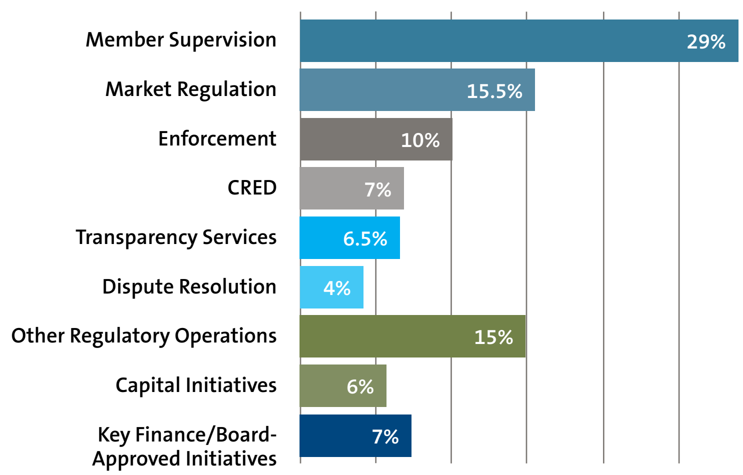
Budget summaries reflect management's internal reporting framework and differ from U.S. generally accepted accounting principles (GAAP). Annual budgets are subject to change during the year as circumstances arise.

Financial Trends *(in millions)*	2019 Budget[1]	2020 Budget[1]	2021 Budget
Operating Expenses	$922.5	$950.4	$984.8
Capital Initiatives	$60.8	$67.5	$64.8
Key Finance/Board-Approved Initiatives[2]	$70.2	$86.5	$83.4
Total Cash Flow Uses	$1,053.5	$1,104.5	$1,133.0
Operating Revenues	$846.9	$868.9	$924.2
Interest and Dividend Income	$20.8	$25.4	$21.3
Potential Reserve Reliance[3]	$185.8	$210.2	$187.5
Total Cash Flow Sources	$1,053.5	$1,104.5	$1,133.0

1. The budget presentation above for 2019 and 2020 has been adjusted to reflect Key Finance/Board-Approved Initiatives, consistent with the 2021 budget presentation.
2. Key Finance/Board-Approved Initiatives reflects costs for Advanced Analytics, New York Real Estate, Digital Experience Transformation, Registration Systems Transformation, Treasuries, Finance Systems Transformation, MPP 2.0, Enforcement Digital 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 *(in millions)*	2021
Member Supervision	$327.5
Market Regulation	$175.9
Enforcement	$113.9
Credentialing, Registration, Education and Disclosure (CRED)	$77.5
Transparency Services	$74.2
Dispute Resolution	$47.1
Other Regulatory Operations[4]	$168.6
Total Operating Expenses[5]	$984.8
Capital Initiatives	$64.8
Key Finance/Board-Approved Initiatives	$83.4
Total Cash Flow Uses	$1,133.0

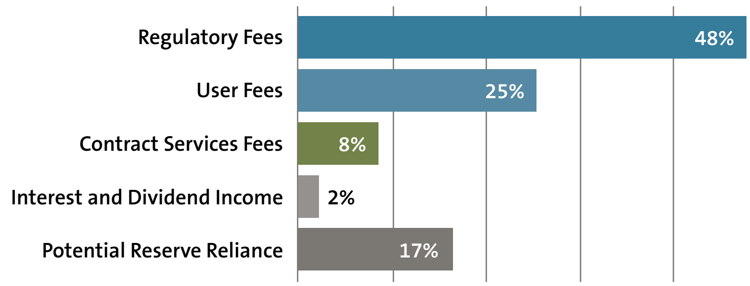
2021 Cash Flow Uses by Key Function



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.

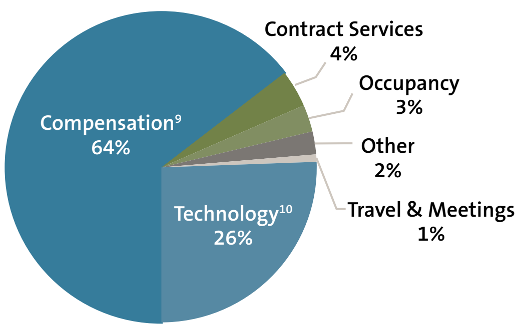
Cash Flow Sources *(in millions)*	2021
Regulatory Fees[6]	$541.8
User Fees[7]	$287.5
Contract Services Fees[8]	$94.9
Total Operating Revenues	$924.2
Interest and Dividend Income	$21.3
Potential Reserve Reliance	$187.5
Total Cash Flow Sources	$1,133.0

2021 Cash Flow Sources by Type

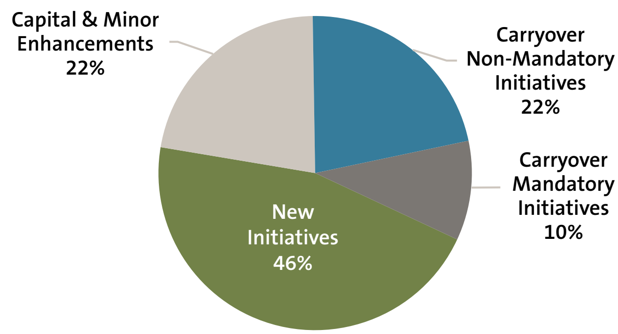


6. Regulatory Fees primarily include the Gross Income Assessment, Personnel Assessment and Trading Activity Fee.
7. User Fees primarily include Registration Fees, Transparency Services Fees, Dispute Resolution Fees, Qualification Fees, Continuing Education Fees, Corporate Financing Fees and Advertising 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 and Form CRS on behalf of the SEC. Contract Services Fees cover the cost of the services being provided.

2021 Operating Expenses



2021 Capital Initiatives by Type[11]



9. Compensation includes only non-Technology staff.
10. Technology includes costs for 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.

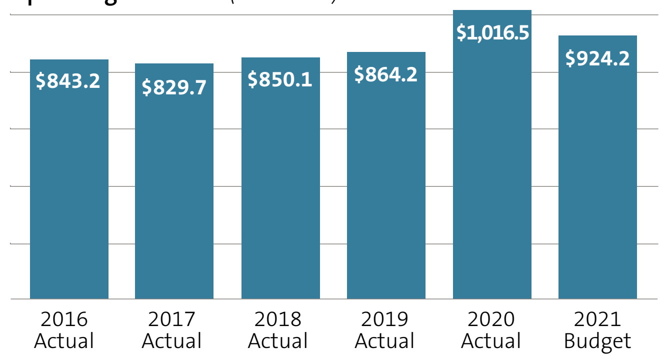
2020 Actuals are preliminary and do not reflect final year-end adjustments.

Historical Trends

Operating Revenues*

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, while another 25 percent of FINRA's revenues is driven from user fees, including registration fees and testing fees. Operating revenue peaked in 2020 due to market volatility driving higher share and trade volume, as well as record-breaking public offering filing volume. Operating revenue is expected to decline in 2021 as market volume settles throughout the year. More detail is available on the next page.

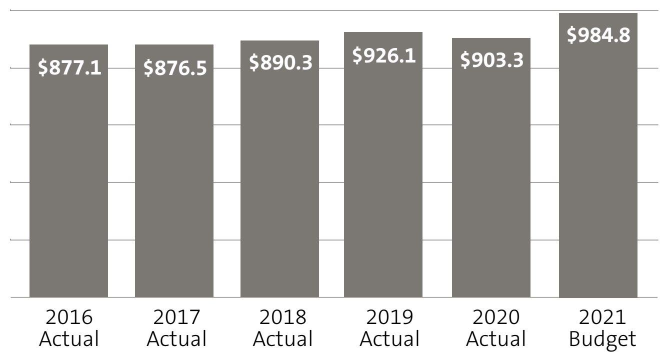
Operating Revenues *(in millions)*



Operating Expenses*

Operating expense increases have stayed largely in line with inflation, at an annual rate of approximately 2.3 percent since 2016. 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 all officer salaries flat again in 2018 and 2021. In 2020, we took steps to help improve FINRA's long-term financial sustainability, including implementing a one-time 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. Also, 2020 and 2021 operating expenses are lower due to the pandemic's effect on FINRA's cost structure.

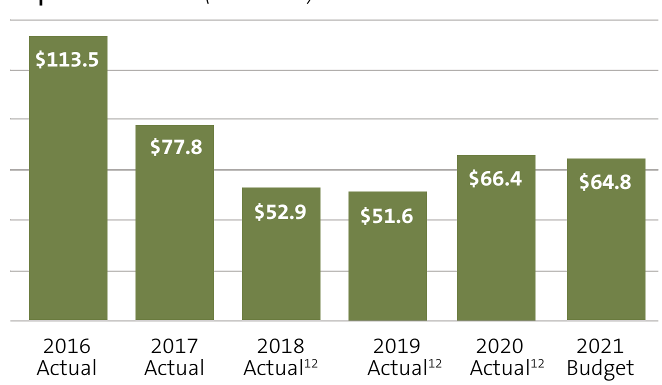
Operating Expenses *(in millions)*



Capital Initiatives*

Capital initiative spending varies from year to year based on the need to enhance regulatory and related technology capabilities. We anticipate capital initiatives of $64.8 million for 2021, which is in line with spending over the last five years. The increased spending in 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.

Capital Initiatives *(in millions)*



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

12. Capital Initiatives spending for 2018 through 2020 has been adjusted to exclude Key Finance/Board Approved Initiatives, consistent with the 2021 budget presentation.

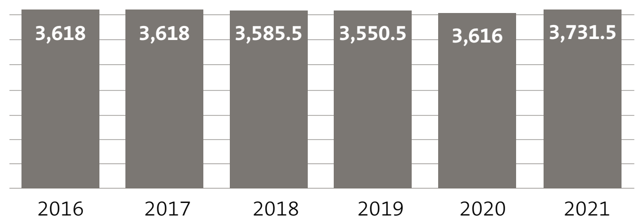
2020 Actuals are preliminary and do not reflect final year-end adjustments.

Workforce

FINRA's fluctuations in headcount since 2016 are largely attributable to changes in regulatory services provided to exchanges. In addition to managing our workforce more effectively, approximately 125 contractors and temporary employees have been converted to full-time staff in recent years. The increase in 2021 is also primarily driven by the creation of the Consolidated Audit Trail (CAT) compliance program.

*The headcount does not include contractors.

Headcount*



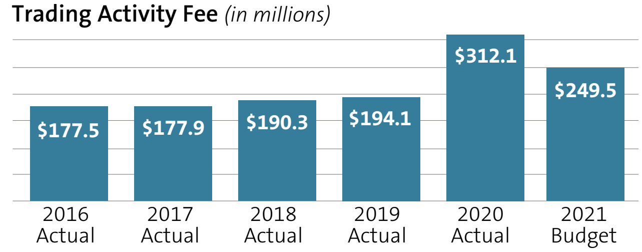
Historical Operating Revenue Trends

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. Increases in 2020 were driven by market volatility; similar increases are expected in 2021.

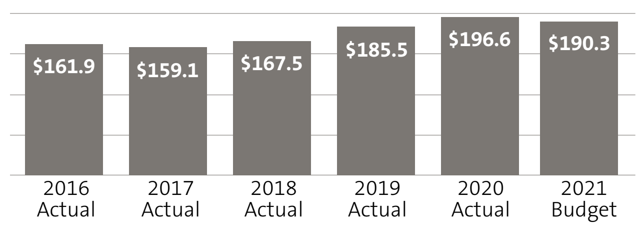
Trading Activity Fee *(in millions)*



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 and is based on a tiered rate structure. Increases since 2017 were driven by an increase in firm revenues; similar increases are expected in 2021.

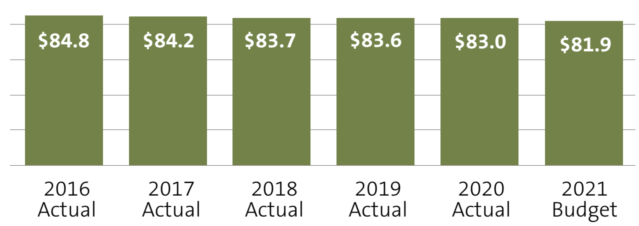
Gross Income Assessment *(in millions)*



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.

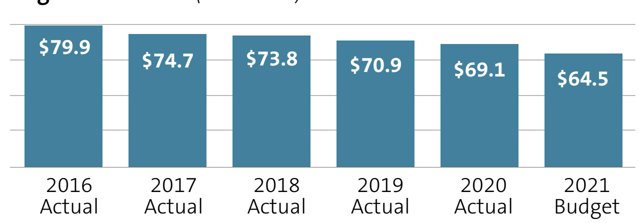
Personnel Assessment *(in millions)*



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 2021 budget is allocated according to the following key functions.[13]

Member Supervision

29%

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

Market Regulation

15.5%

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

Enforcement

10%

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

Credentialing, Registration, Education and Disclosure

7%

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.

Transparency Services

6.5%

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.

Dispute Resolution Services

4%

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.

Other Initiatives

13%

Other initiatives include capital initiative projects and one-time key Finance/Board-approved 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 examination and risk monitoring programs. Key Finance/Board-approved 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 CAT.

Other Regulatory Operations

15%

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 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 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 2021 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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