

Financial Institution Risk Management

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May 29, 2026

FINRA Announces Targeted Sweep on Structured Notes

FINRA has [announced](#) a new targeted examination of member firm practices relating to the supervision of customer concentration in non-principal protected “worst of” structured notes — a higher-risk product category that can expose both interest and principal to risk of loss, based on the worst-performing asset in a group of two or more reference assets. The sweep reflects FINRA’s continued focus on sales practices, product risk, and investor protection, particularly where retail investors may face heightened exposure due to concentrated positions.

Sweeps are often early indicators of FINRA’s examination priorities, and formal declarations of a sweep are relatively infrequent events — as this marks only the second time FINRA has done so in the past three years. Given the intentionality from FINRA about their concerns and the risks associated with this product type, member firms participating in the space should be prepared for scrutiny. Below we cover the scope of FINRA’s inquiry and some takeaways for consideration as member firms encounter regulatory review.

Scope of FINRA’s Review

FINRA is requesting information covering the period January 1, 2022 through December 31, 2025, and is generally focused on how firms:

- Supervise recommendations of these complex structured products
- Ensure compliance with Regulation Best Interest (Reg BI), including Duty of Care and Conflict of interest obligations
- Monitor and manage customer concentration risks in these higher-risk products

FINRA’s inquiries are projected to be very detailed and document-driven and firms should expect to be examined in the following areas:

- Written supervisory procedures (WSPs)
- Product classification frameworks
- Sales restrictions and concentration limits
- Surveillance alerts and exception reporting
- Training programs and requirements
- Compensation structures

- Identification and mitigation of conflicts of interest
- Customer disclosures and education materials

Key Themes Emerging from the Sweep

FINRA's request underscores several recurring regulatory concerns:

1. Concentration Risk Remains a Priority

FINRA is focused on whether firms have effective controls to prevent customers from becoming over-concentrated in higher-risk products. The concern is particularly acute where investors may become disproportionately exposed to a single structured note position.

2. Supervisory Frameworks Must Be Risk-Sensitive

FINRA expects firms to differentiate products by risk profile—including identifying features such as lack of principal protection and “worst-of” payoff structures—and apply heightened supervision accordingly.

3. Surveillance and Alerts Are Critical

FINRA is examining whether firms have automated alerts or supervisory reviews that detect:

- Excessive concentrations
- Suitability or Reg BI concerns
- Outliers requiring escalation

4. Training and Investor Understanding

The regulator is focused on whether:

- Representatives are adequately trained before recommending structured products
- Investors are appropriately educated about risks, including downside exposure and lack of principal protection

5. Compensation and Conflicts of Interest

FINRA continues to scrutinize whether compensation structures may incentivize sales behavior inconsistent with a customer's best interests, and whether firms effectively identify and mitigate those conflicts.

S&K's Recommended Best Practices

This sweep reflects FINRA's ongoing focus on complex products, retail investor protection, and Reg BI compliance and, in our view, reveals several important signals about what FINRA expects from member firms participating in this space. As we have seen, regulators will consistently examine how member firms handle their obligations under Reg BI, including

broker training, suitability assessments, supervisory alerts for over-concentration, and how representatives are compensated for recommending complex instruments. And notably, arbitration claims and awards in this area are also stark reminders of the importance of sound supervision practices.

This sweep and the related regulatory announcement from FINRA present an opportunity for firms to evaluate and, where necessary, enhance their systems. With that in mind, below is a checklist for member firms addressing this issue.

1. Re-Assess Concentration Controls

Firms should evaluate whether their systems:

- Establish clear concentration thresholds
- Generate timely alerts
- Require escalation where thresholds are exceeded

2. Review Product Classification and Governance

Ensure structured notes—particularly non-principal protected products—are:

- Properly classified as higher risk
- Subject to enhanced supervision and approval protocols

3. Test the Effectiveness of Surveillance

Policies alone are not enough—firms should confirm that:

- Alerts are calibrated appropriately
- Exception reviews are properly documented
- Supervisory follow-up is consistent, documented, and defensible

4. Evaluate Training and Representative Readiness

Consider whether:

- Training is mandatory prior to selling structured products
- Firm Materials adequately cover complexity, risks, and investor suitability

5. Scrutinize Compensation Structures

Firms should revisit whether registered representative compensation:

- Creates unintended incentives
- Is aligned with Reg BI obligations
- Is clearly disclosed where required

6. Enhance Customer Disclosure and Education

Clear, accessible disclosure remains critical, particularly regarding:

- Lack of principal protection
- Concentration risks
- Conflicts of interest and compensation

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If you have any questions concerning any of these matters, please contact your primary Seward & Kissel attorney or a member of the [Financial Institution Risk Management](#) practice at Seward & Kissel.