Weathering FINRA's Scrutiny Of Foreign Small-Cap Issuers

By **Michael Watling and Elika Mohebbi** (February 6, 2026)

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On Oct. 23, the Financial Industry Regulatory Authority announced a targeted examination aimed at small-capitalization exchange-listed issuers with ties to business operations in foreign jurisdictions, such as China.[1]

Specifically, FINRA intends to review firms involved with multiple small-cap offerings as either an underwriter, bookrunner, syndicate member, selling group member or placement agent. Additionally, the sweep applies to firms that have participated in initial or secondary market trading related to relevant small-cap offerings.

In connection with its sweep, FINRA seeks such firms to disclose information, including items listed below where relevant, for the period of Jan. 1, 2023, through Sept. 30, 2025.

For firms historically engaged in such activity, now is the time to conduct a self-review of your anti-money laundering and supervision practices in preparation for a potential FINRA inquiry and, in the face of historical inadequacies, to remediate any programmatic weaknesses.

Regulatory Guidance Concerning Foreign Small-Cap Issuer Risk

FINRA Regulatory Notice 22-25

In late 2022, FINRA published Regulatory Notice 22-25, titled "Heightened Threat of Fraud: FINRA Alerts Firms to Recent Trend in Small Capitalization IPOs." This regulatory notice served as the first detailed guidance for member firms to understand what FINRA viewed as the primary risks inherent in dealing with non-U.S.-based small-cap issuers, which were framed primarily in terms of anti-money laundering compliance concerns.

Unsurprisingly, FINRA warned of manipulative trading and so-called ramp and dump schemes, and listed several themes or elements that FINRA observed in such schemes, including the following:[2]

- Issuers with small market capitalization and limited public float, typically raising less than $25 million and valued at less than $100 million, with the initial public offering typically issuing fewer than 20 million shares;

- Foreign issuers, with many — but not all — operating subsidiaries or affiliates based in China;

- Foreign broker-dealers, primarily based in Hong Kong, that have allocated or hold significant amounts — sometimes as much as 90% — of shares issued and outstanding. The practice of allocating a majority of the shares issued in an IPO to a foreign broker-dealer has often coincided with manipulative schemes; and

- Concentrated allocations of IPO shares by underwriters or selling group members — including foreign broker-dealers — to a small number of investors, leading to concentrated ownership of thinly traded shares.

FINRA also reminded firms of their obligations under the Bank Secrecy Act and FINRA Rule 3310, including duties to

> maintain customer identification programs to verify the identity of each customer;
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> verify the identity of the beneficial owners of legal entity customers;
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> establish due diligence programs for correspondent accounts for foreign financial institutions, including omnibus accounts held for foreign financial institutions;
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> establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions; and
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> implement appropriate risk-based procedures for conducting ongoing customer due diligence, including to understand the nature and purpose of customer relationships for the purpose of developing a customer risk profile, and to conduct ongoing monitoring to identify and report suspicious transactions.[3]

2020 SEC Staff Bulletin

Within the 2022 regulatory notice, FINRA cited a U.S. Securites and Exchange Commission staff bulletin from November 2020 that highlighted risks associated with small-cap trading in omnibus accounts, especially when maintained by foreign financial institutions.[4]

Per the SEC's view in the 2020 bulletin, AML compliance under the Bank Secrecy Act requires firms to identify patterns and evaluate risks associated with layers of accounts through which small-cap transactions may be routed.

The bulletin further stated that firms should "consider whether it is appropriate to obtain information regarding the relevant characteristics of ultimate beneficial owners of the funds and securities" and that in instances where "the risks cannot be appropriately managed," broker-dealers should consider refusing to open or close affected accounts, restricting or rejecting questionable transactions, or filing a suspicious activity report.

While the SEC's commentary in 2020 was broader than FINRA's recently announced sweep, it is reasonable to expect that FINRA will examine all areas of risk related to small-cap foreign issuers. Firms that have historically permitted trading of low-priced securities should expect that FINRA will examine those activities broadly to determine whether activity involving foreign issuers or foreign customers was being adequately monitored for AML risks.

FINRA's 2025 Regulatory Oversight Report

FINRA revisited small-cap issuer risk last January in its 2025 regulatory oversight report, apparently having spent the two prior years identifying risk patterns in its member firm examinations.[5]

FINRA described that its initial observations — and those of the major exchanges — involved IPOs of "certain small cap, exchange-listed issuers [being] targets of potential

market manipulation schemes, similar to so-called 'ramp and dump' schemes." Specifically, FINRA and the exchanges observed significant, unusual price increases "on the day of or shortly after the IPOs," which mostly — although not exclusively — involved issuers with operations in foreign jurisdictions.

According to the January 2025 report, by 2024, FINRA was seeing

> unusual price increases occurring less frequently on the day of or shortly after certain small cap issuers' IPOs, but more frequently in the weeks or months after these IPOs.
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> These unusual price increases appear to be associated with manipulative trading of shares originating from apparent nominee accounts that invest in small cap IPOs.
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> These accounts then sell these shares shortly after the IPO, in a manner which appears to funnel them — through manipulative orders and trading activity — to foreign omnibus accounts that accumulate and later liquidate them for profit.

More current manipulation schemes also appeared to involve investor fraud:

> [FINRA] observed an increase in investor complaints regarding social media scams associated with encrypted chat investment clubs, in which bad actors utilize imposter and financial grooming scams to convince investors to purchase shares of small cap companies.
>
> The victims' purchases occur in conjunction with — and likely caused — price increases in the targeted securities.

Notably, FINRA believed that "these purchases often coincided with liquidations of shares by accounts presumed to be controlled by foreign bad actors."

Recent FINRA Disciplinary Matters

In 2025, FINRA filed two enforcement actions against broker-dealers for AML and supervision failures related to foreign issuers.

In March, FINRA took action against Network 1 Financial Securities Inc. and Michael Molinaro, its anti-money laundering compliance officer, for failure to implement a customer identification program that was reasonably designed to (1) "verify the identity of foreign customers opening accounts at Network 1 who did not appear in person at the firm," or to (2) "verify the identity of many customers who opened accounts to invest in initial public offerings (IPOs) for small-cap issuers."[6]

Specifically, FINRA stated that Network 1 established only a generic customer identification program that "did not assess the identity verification risks posed by opening accounts for China-based, issuer-sourced customers."

FINRA censured the firm, fined it $400,000, and required an independent consultant to complete a comprehensive review of the firm's compliance with FINRA's AML rules "and to recommend procedural and systemic changes relating to the same." Molinaro, who had prior regulatory disciplinary history, was suspended for three months in all principal capacities.

That same month, FINRA took action against Redbridge Securities LLC, a firm that provided

an app- and website-based self-directed platform for retail investors, which consented to the entry of findings that it (1) failed to implement an "AML compliance program reasonably designed to detect and cause the reporting of suspicious transactions by the firm's customers," and (2) failed to "implement a reasonable program to achieve compliance with customer identification and risk profile requirements."[7]

The majority of Redbridge's platform customers were "located in high-risk money laundering jurisdictions, including China. Many ... customers regularly bought and sold shares of low-priced securities."

While FINRA acknowledged that Redbridge had a system in place to detect red flag of suspicious transactions, such as high-volume trading and certain kinds of wash trades, it stated that there was no system to identify "suspicious activity that could suggest market manipulation, including cross trading, layering, [or] spoofing."

For these violations, FINRA censured Redbridge and fined it $475,000. It also required Redbridge to retain a third-party consultant to, among other things, evaluate and address the adequacy of the Redbridge's AML program and to make recommendations to improve the firm's "processes, controls, policies, systems, procedures and training" to manage AML risks.

Best Practices for Firms That Have Raised Capital for Foreign Issuers

Firms that have historically raised capital for foreign issuers should expect to be part of FINRA's targeted examination.

Rule number one for such a firm is to show FINRA that it has tailored its supervision and AML system to the risks presented by the business activities involving foreign issuers. In this context, that means that at a minimum, FINRA expects firms to incorporate relevant aspects of its guidance concerning the sale of low-priced and small-cap securities, particularly when issuers of such securities are based outside the U.S.

Firms that permit customers to trade in the over-the-counter markets and on non-major exchanges should have written policies and procedures that track to Regulatory Notice 22-25 and the related SEC staff bulletin from 2020. These firms should also have compliance systems in place — including using exception reports related to small-cap and foreign issuers — to evaluate the risks associated with, for example, increased volatility and limited liquidity.

Compliance systems should also monitor activities of customers trading on these exchanges to identify potential suspicious activity, especially when these customers are based outside the U.S. or have foreign ties. When activity involves a foreign issuer, a firm should apply additional scrutiny to those transactions and escalate review when any red flags exist that might be indicative of manipulation or other forms of misconduct.

From a recordkeeping perspective, firms must document their review if they expect FINRA to credit them for these efforts. In the context of a retroactive examination, FINRA expects that records evidencing review are to have been made contemporaneously.

However, if a firm expects that it will be examined in connection with this sweep, it should conduct a retroactive review of its historical records before a potential examination by FINRA to determine what records exist that evidence the firm's review of small-cap and foreign issuer activities.

In the absence of strong records, firms should consider conducting an additional investigation to determine whether any historical activity that occurred involving small-cap and foreign issuers was part of a potential manipulation or other fraud scheme and should consider self-reporting any questionable activity prior to examination.

Conclusion

Broker-dealers engaged in business with customers or issuers in high-risk foreign jurisdictions, in particular, China, should expect to be part of FINRA's targeted examination.

In advance of such an examination, firms should perform internal reviews of historical activity to identify potential red flags that align with the FINRA and SEC guidance noted above, and ensure that their AML and supervision practices are adequately tailored to the known risks for these business lines and customers. Any material deficiencies should be remediated and evaluated under FINRA Rule 4530 to determine whether self-reporting is appropriate.

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[1] Defined as "Initial public offerings that raise $25 million or less and are priced between $4.00 and $8.00, and follow-on offerings and private placements involving those issuers." FINRA Targeted Examination Letter on Small Capitalization, October 2025.

[2] Regulatory Notice 22-25, FINRA, Heightened Threat of Fraud: FINRA Alerts Firms to Recent Trend in Small-Capitalization IPOs, https://www.finra.org/rules-guidance/notices/22-25.

[3] Id.

[4] Staff Bulletin, SEC, Staff Bulletin: Risks Associated with Omnibus Accounts Transacting in Low-Priced Securities, https://www.sec.gov/tm/risks-omnibus-accounts-transacting-low-priced-securities.

[5] FINRA included small-cap issuer risk in its 2023 Examination and Risk Monitoring Program Report, which it identified as an "emerging risk area." However, the 2023 report was issued only weeks after Regulatory Notice 22-25, and included an abbreviated list of risk items in far less detail than those presented in Regulatory Notice 22-25.

[6] Financial Industry Regulatory Authority Letter of Acceptance, Waiver, And Consent, No. 2022076211301 (Network 1 Financial Securities Inc. et al.).

[7] Financial Industry Regulatory Authority Letter of Acceptance, Waiver, And Consent, No. 2020068737101 (Redbridge Securities LLC).