

Corporate Compliance
211 Main Street, San Francisco, CA 94105-1905



August 23, 2022

Vanessa A. Countryman
Secretary
U.S. Securities & Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: *Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision);*

File No. SR-FINRA-2022-019; Release No. 34-95379

Dear Mrs. Countryman:

Charles Schwab & Co., Inc. and TD Ameritrade, Inc. (“Schwab”) appreciate this opportunity to provide the Securities & Exchange Commission (the “Commission” or “SEC”) with comments in response to the Financial Industry Regulatory Inc.’s (“FINRA”) File No. SR-FINRA-2022-019: Proposed Rule Change to Adopt Supplementary Material .19 (“Residential Supervisory Location”) under FINRA Rule 3110 Supervision (the “Proposal”).¹

Schwab would like to thank the SEC and FINRA for their outstanding efforts during the COVID-19 pandemic. FINRA and the SEC have shown great partnership with the industry responding to the challenges presented by COVID-19.

Overall, Schwab supports most aspects of the Proposal which would model Residential Supervisory Locations after the longstanding primary residence and non-primary residence exclusions that have been in effect since 2005. Given the current and anticipated state of remote work and supervision arrangements, which continue to work well, Schwab urges swift adoption of the proposal. We do, however, wish to raise several concerns and suggestions to enhance the benefits of the Proposal.

I. Background

As a result of the pandemic, member firms have moved to an almost fully remote work environment. Employees increasingly demand permanent workplace flexibility, requiring an update in the rules to provide a more permanent solution than the current temporary relief measures. The Proposal would provide such a solution by modernizing the Supervision rule through aligning FINRA’s definition of an office of supervisory jurisdiction (“OSJ”), and the classification of a location that supervises activities at non-branch locations, with the existing residential exclusions set forth in the branch office definition to treat a private residence at which an associated person engages in specified supervisory activities as a non-branch location, subject to safeguards and limitations.

¹ FINRA, Proposed Rule Change to Adopt Supplementary Material. 19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision), File No. SR-FINRA-2022-019, 87 Fed. Reg. 47248 (Aug. 2, 2022), <https://www.finra.org/rules-guidance/rule-filings/sr-finra-2022-019>.

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The main impact of the Proposal would be that, as a non-branch location, a Residential Supervisory Location would become subject to inspections on a regular periodic schedule (e.g., every three years), rather than the annual inspection required for OSJs and other supervisory branch offices. Without this change, when the temporary Form BR relief ends,² firms would have to choose between requiring employees to return to the office, risking loss of key talent, or dramatically increasing compliance burdens by registering thousands of private residences as OSJs, subject to annual inspections.

Specifically, under the Proposal, an associated person's private residence where a principal conducts supervisory activity will qualify as a non-branch location, provided that the longstanding residential exclusions are met, in addition to certain new criteria. FINRA rules exclude from the definition of a branch office a location according to nine historic criteria that provide the residential supervisory location must: (1) have only one (or a family of) associated person(s) conducting business at the location; (2) not be held out to the public as an office; (3) not be used for meetings with customers or prospective customers; (4) ensure any sales activity taking place at the location complies with the primary and secondary residence exclusions in Rule 3110(f)(2)(A)(ii) and (iii); (5) not handle customer funds or securities; (6) ensure that the associated person(s) are assigned to a specific branch office; (7) ensure communications with the public are subject to the firm's supervision; (8) use electronic communications solely within the broker-dealer's electronic system; and (9) be included on a list of residence locations maintained by the member. The Proposal adds a tenth condition, a restriction from maintaining original books and records at the location. Finally, the Proposal sets forth nine new criteria for certain "ineligible locations."

II. Comments

A. Schwab supports FINRA's Proposal to modernize its rules by adding a Residential Supervisory Location definition

The Proposal represents a positive step in recognizing that the world has changed during the pandemic as most of the industry's workforce now works from home. For more than a year, the industry has operated primarily on a remote basis and has shown during the current "pilot program" that it can properly supervise its various locations without compromising investor protection. The Proposed Residential Supervisory Location definition will enable firms to implement a risk-based approach to workplace locations and inspection timelines, allowing firms to deploy Compliance resources more efficiently.

The move to a hybrid approach for the industry has also allowed Schwab to hire broadly across the entire country instead of localized markets, which profoundly impacts and strengthens Schwab's already robust diversity and inclusion hiring efforts. Any regulatory change that requires Schwab to reconsider such practices would impact these hiring activities. Schwab also

² Under relief granted in March 2020, member firms have not been required to maintain updated U-4 information regarding office of employment address for temporarily relocated registered persons, nor submit branch office applications on Form BR for any newly opened temporary office locations. See Regulatory Notice 20-08 (March 20).

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believes that continued collaboration in this space will further enable member firms to strengthen their efforts around diversity and inclusion and further expand their hiring practices.

B. Schwab believes FINRA can improve the Proposal while furthering its primary goal of investor protection

Schwab supports FINRA's goal of promoting investor protection through identification of certain ineligibility criteria. Schwab encourages FINRA, however, to consider if such proscriptive criteria are necessary for investor protection in light of current member obligations, the diversity of business models in the industry, and the pace of innovation. Instead, FINRA could modify the Proposal to treat the "ineligible locations" section as a general presumption of ineligibility which would require documentation of deviations from the presumption in a member's written supervisory and inspection procedures, including the factors considered in such determinations.

Schwab also believes a more flexible approach is warranted instead of the current proposed disqualification in 3110.19(b)(4) for "*a designated supervisor who has less than one year of direct supervisory experience with the member.*" A regulation requiring a minimum experience level at the member firm for qualified principals well established in the industry does not provide additional investor protection. Firms already have an interest in having only experienced supervisors in remote locations both as a general business practice and to comply with pre-existing obligations under Rule 3110. FINRA should consider supervisory experience at other member firms and/or similar financial services supervisory experience (e.g., at registered investment adviser firms). This disqualification puts members at a competitive disadvantage with non-member financial firms for recruiting purposes and may result in the loss of top talent. FINRA should either remove this requirement or, in the alternative, clarify whether this requirement serves as a safe harbor in connection with a firm's decision to permit designated supervisors with at least one year of experience with the firm to serve as remote supervisors from their residences.

FINRA can further improve another aspect of the Proposal by distinguishing between locations based upon the supervised activities. Schwab does not believe that each location currently subject to the inspection requirement warrants inspection where it does not engage in activities that present a material risk of misconduct or harm. Additionally, firms must balance the true investor protection gained from visiting a particular location in person as opposed to remotely against many factors, including the potential for risk to employee safety in sending an examiner to an employee's home. Firms would be sending examiners into locations that are not vetted corporate locations and do not have the typical safeguards of visiting a corporate location.

Locations with permissively registered individuals, or locations with no client-facing activities such as locations where a principal simply reviews and approves client communications, do not implicate the same level of risk as locations with conduct that requires further regulatory scrutiny. FINRA should only require inspections for locations where the firm holds the location out to the public, personnel meet with customers, the firm holds customer securities or funds, or any other locations that the firm determines involve higher risk such as a

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location with personnel who are subject to heightened supervision. FINRA should exclude from the inspection requirement locations with only permissively registered individuals or those conducting activities entirely on firm systems who do not engage in activities involving a higher risk of misconduct. FINRA should rely on members to internally identify and track locations of non-client facing representatives and supervisors but should not have to register these locations or subject the location to inspection. If FINRA believes risks exist that warrant inspections at these locations, FINRA should clarify which investor protection risks exist requiring review.

III. Remote Supervision & FINRA's Remote Inspections Pilot Program

At Schwab, all associated persons conduct their work exclusively via Schwab systems, all of which are controlled by the firm and subject to appropriate firewalls. All authorized electronic systems are subject to the same controls that are in place at a Schwab office location. This allows supervisors to oversee these activities centrally. This technology further captures all activities electronically for books and records purposes. Schwab technology additionally prevents associated persons from printing remotely and/or conducting Schwab business from other, non-approved devices or systems. Finally, electronic communications created and transmitted by associated persons are automatically retained in a centralized repository. This closed technology system has alleviated the requirement of in person presence at physical locations to maintain equivalent risk management. Schwab views our Branch Office Inspections as simply one aspect of a significantly larger centralized supervisory program.

Schwab encourages the Commission to consider the Proposal in conjunction with FINRA's related proposal concerning the Remote Inspections Pilot Program to ensure consistency. With the increase in remote work arrangements have also come technological solutions to conducting remote inspections. To illustrate this point, Schwab has and will continue to use technology throughout its supervisory program, including when conducting inspections. Schwab conducts most of its supervisory program prior to conducting the exam itself. For example, all electronic communication reviews are conducted on authorized firm systems. This includes supervision and record retention. Technology is utilized to remotely view associated persons' computers to do a desktop review. The firm conducts internet and social media reviews for evidence of outside business activities or personal securities transactions. Even before the pandemic, Schwab conducted almost all of its branch inspection preparation work remotely. Technology advances had eliminated onsite review of physical order tickets and printed trade blotters. Since the start of the pandemic, Schwab has largely transitioned reviews of funds and securities processing from branch locations to utilizing video conferencing both to interview personnel and perform virtual site inspections.

Given the nature of the proposed pilot program and the various temporary relief provisions currently in effect, Schwab strongly encourages the SEC to simultaneously approve both provisions with an effective date on or before the December 31, 2022 sunset of the temporary relief in 3110.17, with an extended compliance date of at least March 31, 2023 in order to make the transition to the new rule, and to conduct an assessment of the data collection on remote inspections. This coordination is essential given that one of the key aspects of the pilot program is data collection on remote inspections segregated by and dependent upon an office's

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classification as an OSJ, a supervisory branch office, a non-supervisory branch office, or a non-branch location. Members will need clear guidance on whether a particular residence needs to be classified as an OSJ or a non-branch location prior to implementing the rule.

IV. Conclusion

Schwab appreciates the opportunity to comment on the Proposal. Schwab also appreciates and supports FINRA's efforts to modernize the Supervision rule. Schwab believes the comments in this letter are consistent with FINRA's efforts to update these rules to recognize the new reality experienced by the industry in terms of remote working arrangements. As a related matter, Schwab would also like to take this opportunity to express support for FINRA's proposal to suppress street addresses in Broker Check. Currently, the home office that is registered shows the full address on Broker Check, presenting privacy concerns. In the proposal, firms can indicate that the location is a private residence and that would suppress the street address on Broker Check. FINRA's adoption of this proposal would help protect the privacy of employees working remotely in their private residences.

Sincerely,

DocuSigned by:

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Barbara Armeli
Managing Director, Chief Compliance Officer
Charles Schwab & Co., Inc.

DocuSigned by:

D1EA904C8D4A428...
Lynn Konop
Managing Director, Chief Compliance Officer
TD Ameritrade, Inc.