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***VIA ELECTRONIC DELIVERY***

Ms. Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

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 Ms. Countryman:

**Introduction**

Two Sigma Securities, LLC (“TSS” or the “Firm”)<sup>1</sup> respectfully submits this letter in response to the above-referenced Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision) (the “Proposed Rule”),<sup>2</sup> filed by the Financial Industry Regulatory Authority Inc. (“FINRA”) with the Securities and Exchange Commission (the “SEC” or the “Commission”) on August 2, 2022.

The Proposed Rule is an effort to have FINRA’s supervision rule (“Rule 3110”) more adequately reflect the current state of the financial industry, which, because of the COVID-

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<sup>1</sup> TSS is a registered market maker focused on providing liquidity through systematic trading strategies across asset classes, which are offered through three core business activities: (1) Market Making and Intraday Alpha; (2) Options Market Making; and (3) Client Trading via our wholesale market making, algorithmic trading services, and single dealer platform offerings. The vast majority of trading activity conducted by these business units is fully automated with minimal human intervention. All orders are received via electronic methods and supervision of such activity is done via electronic tools and reports.

<sup>2</sup> See File No. SR-FINRA-2022-019; Release No. 34-95379, available at <https://www.finra.org/rules-guidance/rule-filings/sr-finra-2022-019>.

19 pandemic, has seen a sharp increase in the number of associated persons working from their private residences on a fully remote or hybrid workplace basis. The Proposed Rule would allow member firms to treat the private residences from which their associated persons conduct supervisory activities as “non-branch locations” for Rule 3110 inspection purposes, subject to certain other limitations and restrictions.<sup>3</sup>

### **Overview of Existing & Proposed Rules**

Rule 3110 currently establishes inspection requirements for the different locations from which member firms may carry out their business activities based on the nature of the location and the activities that member firms and their associated persons are permitted to carry out there. Specifically, Rule 3110 defines “branch office” as “any location where one or more associated persons of a member regularly conducts the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of, any security, or is held out as such”.<sup>4</sup> Rule 3110 defines “office of supervisory jurisdiction,” or “OSJ” as any office of a member at which one or more of the following functions takes place:

- order execution or market making;
- structuring of public offerings or private placements;
- maintaining custody of customers’ funds or securities;
- final acceptance (approval) of new accounts on behalf of the member;
- review and endorsement of customer orders, pursuant to paragraph (b)(2) above;
- final approval of retail communications for use by persons associated with the member, pursuant to Rule 2210(b)(1), except for an office that solely conducts final approval of research reports; or
- responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.<sup>5</sup>

Certain locations, notably, certain private residences, are excluded from the definition of branch office (“residential exclusions”). Provided such locations meet the qualifications

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<sup>3</sup> See FINRA Rule 3110(f)(2)(A)(ii) and Proposed Rule pgs. 5-7 (“Ineligible Locations”).

<sup>4</sup> See FINRA Rule 3110(f)(2)(A).

<sup>5</sup> See FINRA Rule 3110(f)(1).

listed in the rule, they are considered to be “non-branch locations.” However, Rule 3110 also specifies that “*any location* that is responsible for supervising the activities of [associated persons] at one or more non-branch locations of the member is considered to be a branch office” (emphasis added). This means that a residence that fits within the residential exclusions will still be considered a branch office if supervisory activities are conducted there.

Rule 3110 requires that the different locations be inspected on a regular basis, and the required frequency of inspection varies based on the activities conducted at the location.<sup>6</sup> The Rule has effectively created two categories of locations with respect to inspection frequency: (a) those that must be inspected once per year and (b) those that must be inspected at least once every three years. For example, branch offices, residences that supervise other locations, and OSJs (“supervisory locations”) must be inspected once per year. On the other hand, residential locations and branch offices that do not supervise other locations and (“non-supervisory locations”) need only be inspected once every three years.<sup>7</sup>

During the COVID-19 pandemic associated persons were required to work from their homes. This circumstance has persisted across the financial industry as we have emerged from the height of the COVID-19 pandemic. The current industry landscape is such that many member firms permit associated persons to observe hybrid or fully remote workplace

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<sup>6</sup> As used herein, the term “inspection” refers to inspections done in person as well as those done remotely (or “virtually”). Both in person and remote inspections are currently permitted until the end of the year and FINRA has put forth a rule that would allow for remote inspections to continue beyond 2022 on a trial basis for three years. See Proposed Rule Change to Adopt Temporary Supplementary Material .17 (Temporary Relief to Allow Remote Inspections for Calendar Year 2020 and Calendar Year 2021) under FINRA Rule 3110 (Supervision) (Nov. 6, 2020), available at <https://www.finra.org/rules-guidance/rule-filings/sr-finra-2020-040>. See also Proposed Rule Change to Adopt supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision) (SR-FINRA-2022-021), available at <https://www.finra.org/rules-guidance/rule-filings/sr-finra-2022-021>.

<sup>7</sup> See FINRA Rule 3110(c). Note that, while the letter of the rule states that member firms inspect non-branch locations “on a regular periodic schedule,” Supplementary Material .13 states that “there is a general presumption that a non-branch location will be inspected at least every three years”.

arrangements, or some combination thereof.<sup>8</sup> As such, in recognition of the fact that hybrid and fully remote work arrangements are here to stay, as well as the extent to which electronic trading and supervision are being adopted industry-wide, FINRA has put forth the Proposed Rule, which would allow firms to classify residential locations from which supervisory activities are conducted as non-branch locations and, therefore, to inspect them once every three years, as opposed to once a year.

### **Discussion**

1. *Rule 3110 should be revised to state clearly that residential locations where order execution or market making take place may also be classified as non-branch locations.*

Though the Proposed Rule makes clear that a residence from which supervisory activities are conducted may be classified as a non-branch location, there remain ambiguities regarding the proper classification of residences from which other activities identified in Rule 3110 are conducted. Notably, it remains unclear as to whether a residential location that might otherwise be classified as an OSJ due to the non-supervisory activities conducted there (e.g., order execution or market making),<sup>9</sup> may be classified as a non-branch location under the existing residential exclusions.<sup>10</sup>

The stated purpose of the Proposed Rule is to “align 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

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<sup>8</sup> As used herein, the term “hybrid” applies where an associated person who is assigned to a branch office works from a combination of that branch office and their private residence (e.g., two days per week at the branch office and three days per week from their residence, or vice versa). The terms “remote” or “fully remote” apply where an associated person works almost exclusively from a private residence.

<sup>9</sup> See also FINRA Rule 3110(f)(1)(B)-(F).

<sup>10</sup> This, of course, presumes that the residence meets the other qualifications for a residential location to be considered a non-branch location under Rule 3110. See FINRA Rule 3110(f)(2)(A)(ii).

limitations.”<sup>11</sup> However, despite the clarification provided by the Proposed Rule, Rule 3110 would remain unclear as to what activities fall within the scope of the existing residential exclusions. Specifically, the Proposed Rule does not help to clarify whether the residences of associated persons who engage in non-supervisory activities, such as order execution or market making, that would also otherwise fall within the definition of an OSJ, can properly be classified as non-branch locations under the Rule.

The issuance of the Proposed Rule has helped to highlight this ambiguity within Rule 3110 and has made it ripe for clarification. With the classification under the Proposed Rule of residential supervisory locations as non-branch locations, the ambiguity regarding the classification of residences where order execution and market making taking place could lead to counterintuitive interpretations. Indeed, Rule 3110 combined with the Proposed Rule could reasonably be interpreted as requiring that residences where order execution or market making take place be classified as OSJs, while residences that supervise those locations are classified as non-branch locations and, therefore, subject to less stringent inspection requirements. Though we at TSS do not agree with such an interpretation, we recognize that it is a possible interpretation of Rule 3110 as it currently exists. As such, we respectfully request that FINRA further revise Rule 3110 to clearly state that a residential location at which order execution or market making take place may also be classified as a non-branch location, provided it meets the other residential exclusion qualifications under the Rule.

2. *FINRA should create an exception to Rule 3110(c) inspection requirements in the case of associated persons engaged in electronic trading activities from their residences in accordance with a hybrid workplace policy.*

The Proposed Rule reflects FINRA’s acknowledgment of the widespread adoption of hybrid and remote working arrangements in recent years and TSS applauds FINRA’s efforts to modernize its rules and to account for the significant changes in the way that member firms and their associated persons conduct business activities. However, the Proposed Rule, though a step in the right direction, does not go far enough to account for the technological advances and changes in work environment that have taken place over

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<sup>11</sup> See Proposed Rule pg. 3.

the past few years. We think that FINRA should take its rulemaking effort further by recognizing that the nature of electronic trading and hybrid work arrangements is such that efficient and effective supervision can be achieved without the inspection of residential locations. As such, we respectfully request that FINRA codify an exemption from the Rule 3110 inspection requirement in the case of the residences of the associated persons of fully electronic trading firms who observe hybrid working arrangements.

In its discussion of the Proposed Rule FINRA states: “[a]s pandemic-related restrictions are easing, many member firms are moving towards a blended workforce model for their employees, consisting of working on-site in a conventional office setting and working remotely in an alternative location such as a private residence. Similar to the changed environment underlying the Commission’s approval order of the uniform branch office definition that codified the existing seven exclusions, FINRA believes that the structural and lifestyle changes for member firms and their workforce catalyzed by the pandemic—along with advances in technology— merit reevaluation of some aspects of the branch office registration and inspection requirements.”<sup>12</sup>

TSS agrees wholeheartedly with these statements, however, we think that the Proposed Rule falls short of its stated goals in that it fails to appropriately consider the technological capabilities of fully electronic trading firms – which are currently a much more significant part of the industry than when Rule 3110 and its various amendments were initially conceived – and the ability of such firms to use electronic methods to effectively supervise associated persons engaged in hybrid working arrangements.

Today, trading and market making are largely electronic processes. Fully electronic trading firms like TSS use entirely electronic trading systems, apparatus, and communication systems to facilitate their activities. Orders are created, received, and routed or executed primarily through algorithmic processes and with minimal human intervention. Electronic

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<sup>12</sup> See Proposed Rule pg. 27. See also Proposed Rule pg. 36 (“FINRA acknowledges the shift towards a permanent blended or hybrid workforce model and therefore believes under the current environment, private residences responsible for the supervisory activities and subject to the conditions described above should not require registration as branch offices. The [Proposed Rule] is intended to reflect a pragmatic balance between the hybrid workforce model and the parameters that should ensure that all locations, including residential locations, are appropriately supervised.”)

broker dealers send orders through a FIX connection, or other similar electronic communications networks, and internal algorithms determine exactly how to route or execute the order. Any human intervention in this process is done electronically and is captured by the firm's trading systems. Indeed, in the case of firms like TSS, no trading activity occurs that is not captured in the Firm's electronic systems. Such firms also use fully electronic communication systems and record keeping methods to support their trading activities, and they employ electronic methods of supervision and surveillance of their trading activities. Every step of the trading process is electronically logged and monitored throughout the trading day. Consequently, the trading activities, and communications of the associated persons of electronic trading firms are subject to constant centralized electronic surveillance and supervision, regardless of their location.

With respect to associated persons engaged in electronic trading who observe hybrid working arrangements, the fact that such employees are physically present at their assigned branch offices on a regular basis provides for additional opportunity for supervision and surveillance of their activities to the extent necessary. That said, when considered together, the nature of electronic trading and hybrid work arrangements is such that many of the factors associated in the Rule with less stringent inspection requirements are inherent therein. Indeed, TSS associated persons who engage in electronic trading while observing hybrid work arrangements (i) do not hold their residences out to the public or use them to meet with customers, (ii) do not handle customer funds or securities at their residences, (iii) are assigned to – and regularly present in – a designated branch office of the Firm, and (iv) engage in communication only through the Firm's electronic systems, which are subject to Firm supervision.<sup>13</sup> Certainly, we can appreciate that were these conditions not present, there may be some need to conduct inspections. If associated persons while working from home were meeting with customers, accepting customer funds, storing physical copies of firm records, accepting orders in person or over the phone, or otherwise engaging in trading activities outside the purview of the firm's electronic trading systems, we could appreciate the need for some periodic inspection. Similarly, in the case of remote

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<sup>13</sup> See FINRA Rule 3110(f)(2)(A)(ii) for the complete list of qualifications for residential non-branch locations.

employees who are rarely if ever appearing in person at a branch office, an inspection requirement might be reasonable.

However, given the nature of electronic trading and hybrid work, and the ability of such firms to electronically supervise the activities of their associated persons engaged therein, there is little need to require inspection of the residential locations of those associated persons. Associated persons of electronic trading firms who engage in hybrid working arrangements present no greater risk than those working from branch offices simply because they use their laptops in a home office rather than a firm office. Inspecting the private residences of such persons is an unnecessary burden that confers no material benefit.

### **Conclusion**

The Proposed Rule is an important step forward in modernizing the Rule 3110 inspection requirements. However, the Rule could benefit from some clarity regarding the extent to which residential locations where order execution and market making take place may be classified as non-branch locations. Furthermore, the fact that the Rule would continue to require the inspection of the homes of associated persons who engage in hybrid work does not adequately take into consideration the wholly electronic trading activities of TSS and many other member firms, as well as the technological infrastructure that supports supervisory capabilities in the financial industry today. TSS respectfully requests that FINRA reconsider the requirement under Rule 3110 that firms inspect the homes of their associated persons who engage in electronic trading activities from home in accordance with hybrid workplace arrangements.

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The Firm recognizes and appreciates FINRA's efforts to bring its rules into alignment with the current environment in the securities industry by recognizing the need for periodic updates like the Proposed Rule. We are grateful for the opportunity to comment on the Proposed Rule.

Sincerely,

*Sandip Khosla*

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Sandip Khosla  
General Counsel