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J. Matthew DeLesDernier
Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Release No. 34-95452; File No. SR-FINRA-2022-021
(Remote Pilot Inspection Program)

Dear Mr. DeLesDernier:

The Cornell Securities Law Clinic (the "Clinic") submits this comment opposing the rule proposal (the "Proposed Rule") of the Financial Industry Regulatory Authority ("FINRA") to Adopt Supplementary Material .18 (Remote Pilot Inspection Program) under FINRA Rule 3110 (Supervision). The Clinic is a Cornell Law School curricular offering in which students provide representation to public investors and public education as to investment fraud in the "Southern Tier" region of New York. For more information, please see http://securities.lawschool.cornell.edu.

Supplementary Material .18 would amend FINRA Rule 3110 (Supervision) to allow firms to inspect some or all branch offices remotely to satisfy Rule 3110(c) (Internal Inspections).[1] This remote supervision would be part of a voluntary, three-year remote inspection program. At the end of the program, FINRA aims to use the data from the pilot program to assess the impact of virtual supervision on firms' overall supervisory systems.[2]

The pilot program would essentially continue the remote inspections FINRA temporarily authorized under Rule 3110.17.[3] FINRA enacted that rule in November 2020 to allow firms to conduct virtual inspections due to COVID-19.

[1] Proposed Rule at 1.
[2] *Id.* at 5-6.
[3] *Id.* at 5.

I. FINRA SHOULD COMPILE ITS DATA FROM REMOTE SUPERVISION DURING COVID TO CREATE A MORE COMPREHENSIVE RULE PROPOSAL RATHER THAN A PILOT PROGRAM

The Clinic's main concern is that FINRA has not presented analysis of data from the COVID virtual supervisions. In particular, FINRA states that assessing virtual supervision systems has "not been feasible with information drawn from the pandemic-related office shutdowns."[4] The nearly two years of virtual supervisions during COVID could have been a perfect test for the permanent implementation of virtual supervision. FINRA could have collated that data and made a more comprehensive case for permanent virtual supervision.

The Clinic has similar concerns about the Proposed Rule as expressed by the North American Securities Administrators Association, Inc. ("NASAA").[5] The Proposed Rule seems unnecessary because it would provide firms with three more years to gather data when those same firms have been under remote supervision since November 2020. If, as NASAA alleges, FINRA has been unhelpful in providing this data,[6] that situation seems to be more proof that there needs to be a comprehensive data analysis process before adopting the Proposed Rule.

If the data provides negative insights into remote inspection, the public deserves to see those results before authorizing a pilot program. The pilot program should not serve as an opportunity to allow firms to continue remote inspection if there is already data indicating these remote inspections do not function properly.

For example, FINRA recently published Regulatory Notice 22-10 on Supervision.[7] There, FINRA stated that it had brought around 440 enforcement actions "involving violations of Rule 3110 for supervisory failures" between 2018 and 2021.[8] That data provides plenty of opportunity for analysis regarding remote supervision. For example, of those 440 enforcement actions, it's possible that a majority were during the period of remote supervision. If so, that statistic could provide insight into the efficacy of remote supervision.

As it stands, the Remote Pilot Inspection Program has plenty of theoretically positive aspects. No regulatory agency should unnecessarily impede technological progress, especially when that technology may make the lives of firms easier. However, much of the Proposed Rule reads as though COVID never happened. It feels strange to have a "pilot program" after Rule 3110.17—which behaved in a similar manner to a pilot program.

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[4] *Id.* at 5-6.
[5] *See* Letter from Melanie Senter Lubin, NASAA President, to J. Matthew DeLesDernier, SEC Assistant Secretary, *Re: Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision) and Release No. 34-95379, Notice of Filing of a Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision)* (Aug. 23, 2022) at 4-5, *available at* https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20137299-307862.pdf.
[6] *Id.*
[7] FINRA, Regulatory Notice 22-10, *Supervision* (Mar. 17, 2022), https://www.finra.org/rules-guidance/notices/22-10.
[8] *Id.* at 6 n.4.

In conclusion, the Clinic opposes the Proposed Rule for its lack of comprehensive data regarding remote supervision during COVID.

II. FINRA SHOULD FURTHER CONSIDER DISPARITIES AND DIFFERENCES BETWEEN FIRMS OF VARYING SIZES IN ITS REMOTE SUPERVISION PROGRAM

The Clinic is concerned that larger firms, those with the best ability to implement complex technologies for supervision, are those most likely to be at risk without in-person inspections.

In 2004, the Securities and Exchange Commission ("SEC") released Staff Legal Bulletin No. 17, which warned of the supervisory dangers of remote offices.[9] While the Legal Bulletin was published before the rise of Zoom and similar technologies, its admonitions were strong and are particularly relevant for the Proposed Rule. For example, the Legal Bulletin states, "Inspections are a vital component of a supervisory system. The Commission has determined that broker-dealers that conduct business through remote offices have not adequately discharged their supervisory obligations where there are no inspections of those offices."[10]

Furthermore, the Legal Bulletin specifically encourages "firms to use unannounced, onsite inspections of remote offices to enhance supervision."[11] Since 2004, technology for supervision has advanced demonstrably; however, FINRA has not laid out a rationale in the Proposed Rule as to why these concerns are no longer valid. Indeed, the Proposed Rule suggests that supervisors *may* visit an office in person unannounced, but only for offices with "red flags."[12]

Perhaps FINRA is correct in its conclusion that unannounced, in-person visits are not necessary in every instance. However, once again, FINRA has not provided concrete data from the COVID period of remote supervisions to justify that belief.

Relatedly, the necessity for different kinds of supervision may well be drastically distinct across firms of varying sizes. FINRA recently published a report on technological innovations for regulatory compliance in the securities industry.[13] In the report, FINRA devoted a section to how these technologies could impact firms' abilities to abide by FINRA supervisory requirements.[14] Throughout that section, FINRA repeatedly concedes that the technology is "highly complex and sophisticated."[15] It also mentions that these technologies can actually

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[9] SEC, Staff Legal Bulletin No. 17, *Remote Office Supervision* (Mar. 19, 2004), https://www.sec.gov/tm/staff-legal-bulletin-17-remote-office-supervision.
[10] *Id.*
[11] *Id.*
[12] Proposed Rule at 31.
[13] FINRA, *Technology Based Innovations for Regulatory Compliance ("RegTech") in the Securities Industry* (Sept. 2018), https://www.finra.org/sites/default/files/2018_RegTech_Report.pdf.
[14] *Id.* at 7-8.
[15] *Id.*

increase supervisory risk and that firms should therefore put in place policies to protect against that risk. However, the Proposed Rule does not provide enough detail regarding the content of these policies.

Admittedly, the Proposed Rule provides for an *optional* remote supervision program. Smaller firms without the resources to learn and implement these "complex" technologies can still perform in-person inspections. However, one of the benefits of a remote supervision system is the cost.[16] Unfortunately, if smaller firms cannot afford these advanced technologies, then only larger firms can properly implement remote supervision. Nevertheless, larger firms with many remote offices are those most at risk of supervisory violations.

In conclusion, the Clinic is concerned that remote supervision may not be feasible for smaller firms, those most likely to benefit from it. Likewise, larger firms, those with the resources to implement these technologies, may be those most at risk under remote supervision.

Conclusion

The Clinic appreciates the opportunity to comment on the Proposed Rule. We hope the SEC considers our concerns in determining whether to accept the proposal.

Respectfully submitted,

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[16] *See* Letter from Stefanie Steel, Liberty Capital Investment Corp. Manager of Operations Compliance, to SEC, *Re: SR-FINRA-2022-021* (Sept. 1, 2022), *available at* https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-308259.htm.