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September 6, 2022

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

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

Re: File No. SR-FINRA-2022-021 and Release No. 34-95452: Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110

Dear Ms. Countryman:

This will serve as comments of Cetera Financial Group, Inc. ("Cetera") with respect to a proposal by the Financial Industry Regulatory Authority Inc. ("FINRA") to add Supplementary Material .18 to FINRA Rule 3110. The proposed change would create a pilot program under which FINRA member firms would be permitted to perform inspections of branch office locations remotely under specified circumstances. We will refer to the pilot program and related matters described in Supplementary Material .18 collectively as the "Proposal".

Cetera is the corporate parent of five FINRA member firms with more than 8,000 registered representatives doing business in all 50 states. The majority of our office locations house less than five registered individuals and we maintain a large number of registered branch offices as a result. This issue is of considerable importance to Cetera and all other FINRA member firms, regardless of their size and geographic scope.

FINRA Rule 3110(c) includes a provision requiring all member firms to perform in-person inspections of branch office locations on a prescribed schedule. It specifies that every Office of Supervisory Jurisdiction ("OSJ") be inspected at least once per year, all branch offices be inspected no less frequently than every three years, and that all non-branch locations be inspected on a periodic schedule based on an analysis by the firm.

Beginning in March, 2020, the COVID-19 pandemic rendered in-person branch office inspections virtually impossible. Public health concerns and accompanying government mandates dictated that FINRA member firms conduct virtually all business remotely, including branch inspections.

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Recognizing the scope and potential duration of these circumstances, FINRA adopted temporary changes to Rule 3110, allowing branch office inspections to be performed remotely.[1] That relief is scheduled to expire on December 31, 2022.

FINRA member firms appear to have adapted well to the disruptions brought about by the COVID-19 pandemic. Most successfully reoriented their operations to allow workers to operate remotely, usually from their personal residences, and quickly shifted to performing branch inspections remotely. We will discuss this in more detail below, but the necessity of performing branch inspections remotely for the past two years has established that the results of inspections performed remotely are substantially similar to those obtained in-person.

FINRA has described the background and rationale behind the proposed three-year pilot program very comprehensively, and Cetera strongly supports the adoption of Rule 3110.18. The Proposal is a well-reasoned approach and takes note the benefits of modernizing the FINRA framework for supervision of all business activities by member firms. The securities industry has moved steadily away from paper-based, in-person supervision models toward a more sophisticated and effective regime that relies primarily on the use of electronic technology. This trend has occurred for several reasons: The growth of the industry, increase in the number of investors and customer accounts, the proliferation of new investment products, and the rapid adoption of electronic communications by both FINRA members and customers. Electronic oversight of activities performed by representatives and other employees is demonstrably more effective than occasional in-person interactions of the type produced by physical branch inspections. We believe that the FINRA pilot program can and will objectively demonstrate that there will be no material reduction in investor protection if these changes are implemented.

With all of the above as background, we offer the following specific comments with respect to the Proposal:

1. **The Proposal is representative of a broader and long-needed change in industry practices relating to supervision.**

   The major portions of FINRA Rule 3110, including the provisions requiring in-person branch inspections, have been in place for more than 25 years. In many ways they reflect a business environment that no longer exists. The volume of transaction activity, number and breadth of investment products available, and widespread adoption of electronic communications have fundamentally changed the securities industry and how business is conducted and supervised.

   Technology has allowed firms to make better decisions about how to utilize their supervision and compliance resources. For example, in 2000, relatively few firms utilized e-mail or instant messaging on a large scale for communications with customers. Review of correspondence was largely a manual process which was both time-consuming and inefficient. In 2022, the vast majority of communications with customers are electronic. This has allowed FINRA members to utilize technology to

[1] FINRA Rule 3110.17

review correspondence much more efficiently and effectively. Instead of manually reviewing order tickets, most transaction surveillance is now done through electronic systems. This is more efficient and far more likely to identify issues that require additional attention. Perhaps more importantly, it allows multiple individuals in different locations to perform the work instead of relying on a single or small group of supervisors in a given office location.

We would also note that even prior to the onset of the COVID-19 pandemic, both FINRA and the SEC had fundamentally changed their own practices in conducting routine or cycle examinations of broker-dealers. In 2000, a typical broker-dealer examination by FINRA or the SEC would consist of staff members spending several weeks onsite at the firm, reviewing documents and speaking with representatives of the broker-dealer. This regime has changed substantially. Instead of spending weeks onsite at the firm, examiners from the SEC or FINRA usually issue requests for documents and information to the firm weeks prior to commencement of the actual review. This material is evaluated by the examiners remotely, and it is unusual for regulators to spend more than a few days physically present at the firm's offices during an examination.

FINRA and the SEC adopted this approach after considering its effectiveness and consistency with their mission of investor protection and determined that what they gained in efficiency more than offset anything lost through lack of physical presence at the firm. The same logic applies to in-person branch inspections conducted by FINRA member firms. The rare occasions in which physical presence uncovers evidence of wrongful conduct are more than offset by the efficiencies gained in performing most of the work remotely. Firms should be permitted to determine the methods by which they choose which branches to visit in person and under what circumstances.

2. **Branch inspections represent only one element of an effective supervisory system.**

Branch inspections, whether in-person or remote, are only a single element of an effective supervisory system. Given the evolution of electronic oversight capability, experience demonstrates that branch inspections are less important than they may once have been. The activities conducted in branch offices vary widely. For example, at Cetera, many of our branches are located in depository financial institutions such as banks and credit unions. The product offerings at these locations are often limited, and customer records are often not maintained in the branch. Branches of this type present lower risk profiles for both the firm and customers. Performing physical examinations of these locations diverts scarce supervision and compliance resources from offices that are larger, handle customer funds and securities, or offer a broader or more complex product menu. The balance weighs heavily in favor of allowing firms to make risk-based decisions about where to apply supervisory resources, subject to reasonable conditions such as those outlined in the Proposal.

3. The Proposal is an appropriate means to test the long-term viability of a remote branch inspection framework.

The Proposal would allow FINRA to implement a pilot program under which member firms could conduct branch inspections remotely under specified circumstances. We believe that a permanent rule change is justified, but since the Proposal represents a substantive change to the current regime, a pilot program that will allow for a more comprehensive collection of data and test of FINRA's assumptions is appropriate.

FINRA did not seek public comment on the Proposal prior to submitting it to SEC. This is due in part the pending expiration of the temporary relief provided in Rule 3110.17, but also reflects the fact that FINRA previously sought comment regarding the experience of both member firms and others in dealing with the COVID-19 pandemic.[2] FINRA received submissions from a fairly diverse group of commentors, including members of the public. Many of the comments submitted by FINRA member firms refer to their experience with remote branch inspections, and several noted that the findings in remote branch inspections, both in quantity and severity, were very similar to their experience with in-person branch inspections. It may be difficult to apply our experience to those of other firms, but Cetera conducted more than 3,000 remote branch inspections in 2020 and 2021. Our experience indicates that both the frequency and severity of findings in all inspections was very similar under both methods.

A pilot program such as that in the Proposal will allow FINRA to determine, based on objective evidence, whether or not remote inspections are as effective as those conducted in-person. It includes a requirement for member firms to submit detailed data regarding remote inspections that FINRA would not otherwise obtain. A pilot program offering the chance to test these assumptions represents the best of both worlds for member firms, FINRA, and customers. More and better data leads to better-informed and higher-quality decision-making. If the results of the pilot program do not bear out FINRA's hypothesis, the changes embodied in the Proposal will be allowed to expire without further action. The represents an optimal balance between allowing firms flexibility to design their own risk-based protocols and maintaining investor protection.

It has been suggested by some commenters that in-person branch office inspections have a unique value because they offer the opportunity to detect wrongful conduct by representatives that would not otherwise be identified. We have no doubt that there have been instances in which this has been the case, but we believe that an objective assessment will demonstrate that it is so rare as to be nearly meaningless as a criterion in deciding to accept or reject the Proposal. Cetera conducted more than 3,000 in-person branch inspections during the period from 2017 through 2019,

[2] FINRA Regulatory Notice 20-42 (December 16, 2020).

the most recent period for which data is available. We were able to locate only a few instances in which wrongful conduct was first identified during an in-person branch inspection, and believe that the conduct at issue would have been identified through other means in almost all cases. We do not make this statement to suggest that the Cetera branch office inspection program is perfect. Neither we nor any other firm can credibly make such a claim. However, we would note that the number of instances in which improper activity has been discovered through review of email and other electronic communications, surveillance of transaction activity, and direct contact with customers or other members of the public vastly outnumbers matters identified during branch inspections.

Every industry has bad actors who knowingly violate the law, and broker-dealers are no exception. Individuals who make conscious decisions to break the rules also take actions designed to avoid detection. To suggest that in-person inspections are significantly more likely to uncover evidence of wrongdoing cannot be supported by available evidence of which we are aware.

It is beyond dispute that the cost of supervision and compliance and the portion of FINRA member firm revenues devoted to those activities have both risen steadily over the past 20 years. Cetera understands and embraces this fact. Investments in supervision and compliance programs are necessary to protect investors and also yield material benefits by enhancing the reputation of both our firm and the securities industry in general. We are not suggesting that by participating in the FINRA pilot program member firms should be given carte blanche to reduce their spending on supervision. The Proposal simply gives firms a better ability to determine how resources should be allocated. The pilot program proposed by FINRA will allow both and member firms to objectively establish that applying resources to other supervision methods will yield greater benefits than if they are devoted to in-person branch inspections.

Cetera has not performed any significant number of in-person branch inspections since 2020, and our expenditures on supervision and compliance programs have not diminished. The question is not whether an appropriate level of supervision and oversight will occur. FINRA rules dictate that all members firms meet those obligations. The question is: Given the resources that are available for the task, what is the most efficient method to meet those obligations. The ultimate aim of a branch office inspection program is to promote and enhance investor protection. The Proposal will assist in accomplishing that goal while giving broker-dealers the flexibility to focus on the branch offices, representatives, and activities that they believe create the greatest risks.

4. The Proposal contains significant safeguards to assure investor protection.

The Proposal includes several elements designed to assure that its adoption will not result in any diminution of investor protection. In particular:

- The pilot program will not be available to FINRA member firms that have demonstrated an inability or unwillingness to conform to industry regulations and standards. In particular, firms subject to the provisions of FINRA Rule 3170 (the "Taping Rule") and Rule 4111, which applies restrictions based on the involvement of firm representatives in certain events involving alleged violation of laws or industry regulations would not be eligible to participate. The Proposal would also require in-person inspection of branches which house individuals subject to heightened supervision, statutory disqualification, or who have been involved in events that are reportable on the Forms U4 of individual representatives.

- The Proposal requires firms relying on Rule 3110.18 to report the results of branch inspections to FINRA on a regular basis, and to adopt Written Supervisory Procedures that specify the criteria for how inspections will be conducted. These provisions will offer FINRA the ability to monitor the results of the pilot on a real-time basis and make adjustments to the program if necessary.

It has been suggested by some commenters that if the Proposal is adopted, many FINRA member firms will cease performing in-person branch inspections. We do not believe that this is the case, and will state for the record that Cetera has no intention of doing so. We have maintained our entire pre-COVID staff of branch examiners, and fully intend to commence performing in-person branch inspections in 2023. However, if the Proposal is adopted, we will not simply revert to the current system under which all branch offices are considered the same. We intend to perform a risk-based analysis of all branch locations, including the individuals who operate in them, the products and services they offer, the profile of the client base they serve, and issues particular to the representatives in the branch. Factors would include any history of customer complaints, involvement in regulatory actions, or evidence of a history of involvement in questionable sales practices. We are convinced that this will produce a better overall result.

5. The pending expiration of Supplementary Material 3110.17 makes rapid consideration of the Proposal imperative.

FINRA adopted Supplementary Material 3110.17 to allow member firms to perform branch inspections remotely through December 31, 2022. The COVID-19 pandemic has abated to some extent, and it appears that it will be feasible for member firms to conduct at least some branch inspections in person starting in 2023. However, the effects of COVID-19 have been unpredictable, and it is entirely possible that there will be one or more recurrences of the lockdowns and other travel restrictions that persisted during 2020 and 2021.

FINRA members also need time in which to plan their branch inspection programs for 2023 and beyond. A reversion to the old regime embodied in Rule 3110(c) would require Cetera to conduct an average of more than 150 in-person branch inspections each month in 2023. Planning those visits involves a large logistical undertaking and cannot be accomplished overnight.

Expiration of the current FINRA regime will occur less than four months from today. We respectfully request that whatever action the Commission ultimately takes with respect to the Proposal be concluded quickly in order to allow firms sufficient time to plan and organize their inspection programs for 2023. We also request that, if the circumstances do not allow for a final decision on adoption of the Proposal prior to December 31, 2022, the Commission authorize an extension of the current relief contained in Rule 3110 .17 for at least 6 months in order to allow firms sufficient time to plan and execute their inspection programs.

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We appreciate the opportunity to submit comments on this important matter and thank you in advance for your consideration. If we may offer further information on any of the matters discussed, please let me know.

Sincerely,

Mark Quinn
Director of Regulatory Affairs
Cetera Financial Group