



September 06, 2022

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

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

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

Dear Ms. Countryman:

The Securities Industry and Financial Markets Association (“**SIFMA**”)¹ appreciates this opportunity to provide the Securities and Exchange Commission (the “**Commission**” or “**SEC**”) with comments in response to the Financial Industry Regulatory Authority Inc.’s (“**FINRA**”) File No. SR-FINRA-2022-021: Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision) (the “**Proposal**”).²

SIFMA and its members would like to thank the SEC, FINRA, and their staff for their extraordinary efforts during the COVID-19 pandemic. The SEC and FINRA have been outstanding partners in coordinating with the industry and responding to the various challenges presented by COVID-19. As we continue to navigate these uncertain times, we anticipate our engagement with the SEC and FINRA will continue to be collaborative as we determine how to regulate in a post-COVID-19 world.

SIFMA appreciates the significant effort that FINRA and its staff have invested in the Proposal, which reflects meaningful input from fellow regulators and the industry over the past two years. SIFMA supports the Proposal and commends FINRA for continuing to revisit the necessity of on-site inspections and building on the temporary off-site inspection procedures that have been operational since November

¹ SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the United States and global capital markets. On behalf of our industry’s nearly one million employees, we advocate for legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (“**GFMA**”).

² FINRA, *Proposed Rule Change to Adopt Supplementary Material. 18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision)*, File No. SR-FINRA-2022-021, 87 Fed. Reg. 50144 (Aug. 15, 2022), <https://www.finra.org/rules-guidance/rule-filings/sr-finra-2022-021>.

2020 under FINRA Rule 3110.17. FINRA, with the input of its Board³ and advisory committees,⁴ proposed a well-designed pilot to gather data to assess the viability of a proposed rule change. It would be in the interest of all parties for the Proposal to be swiftly adopted. FINRA could begin collecting and assessing mandatorily required data sooner, and firms would have greater regulatory certainty for their inspection programs and workforce in a post-pandemic era.

I. Necessity of the Proposal

A. Recruiting and Retaining a Qualified and Diverse Workforce Necessary to Investor Protection

The COVID-19 pandemic forced a fully alternative work environment upon the industry and a fundamental shift in workforce expectations. Supported by technological advancements made over the past decade by the industry and fully tested during the pandemic, employees know they can do their jobs from any physical location and are demanding workplace flexibility.⁵ In addition to retaining the current, qualified workforce, the industry must be prepared to recruit the next generation of employees who are growing up with even greater use of technology and flexibility. The ability to offer workplace flexibility will attract the best and brightest and further efforts to diversify the industry, a goal Congress had in the Dodd Frank Act.

The Federal Government and various state government organizations recognize this trend in workforce expectations and the benefits that flexible work arrangements can bring to an organization and the industry. Chair Gensler, for example, has consistently praised SEC staff for working remotely and the SEC's recently released strategic plan calls for "maximiz[ing] telework opportunities."⁶ In its November 2021 update, the U.S. Office of Personnel Management ("OPM") said, "[a]s we look to the future, OPM is encouraging agencies to strategically leverage workplace flexibilities such as telework, remote work, and alternative/flexible work schedules as tools to help attract, recruit, and retain the best possible workforce," and "[t]he Federal Government, as the nation's largest employer, is well-positioned to leverage telework, remote work, and other workplace flexibilities to adapt to the changing needs of the workforce of the future."⁷ The State of Maryland "...views telework as a valuable tool in recruiting and retaining a high

³ We note that FINRA's Bylaws designate 11 spots, a majority, to public members that are not associated with an industry member. See FINRA Board of Governors, <https://www.finra.org/about/governance/finra-board-governors>.

⁴ FINRA utilizes numerous advisory committees that provide input on proposals. Of particular note, not only did the Large and Small Firm Advisory Committees have the opportunity to provide input, but also the Investor Issues Committee. Combined with input from the Board's Public Governors, it is reasonable to assume that investor concerns were addressed. To highlight, the Investor Issues Committee "... is composed of subject matter experts, including academics, consumer advocates, former securities regulators, institutional investors and individuals affiliated with non-broker-dealer asset management firms. The committee advises FINRA staff on matters that significantly affect individual and institutional investors, including proposed rulemaking, policy initiatives and other issues, and to help inform FINRA's economic analysis from the perspective of investors. In addition, the committee routinely reviews rule proposals and regulatory initiatives before they are brought before the FINRA Board." For more information on each of the Advisory Committees, see, <https://www.finra.org/about/governance/advisory-committees#iic>.

⁵ Amongst the litany of reporting on this trend, the most recent article at the time of this writing is *The Office's Last Stand*, NY Times (Aug. 28, 2022), <https://www.nytimes.com/2022/08/28/business/the-offices-last-stand.html?smid=em-share>.

⁶ SEC Chair Gary Gensler Speaks with CNBC's "Squawk on the Street" Today (pub. Aug. 26, 2022), <https://www.cnbc.com/2022/08/26/cnbc-exclusive-cnbc-transcript-sec-chair-gary-gensler-speaks-with-cnbc-squawk-on-the-street-today.html>; see also, Testimony Before the United States Senate Committee on Banking, Housing, and Urban Affairs (Sept. 14, 2021), <https://www.sec.gov/news/testimony/gensler-2021-09-14>; see also, SEC Strategic Plan, Fiscal Years 2022-2026, at p. 13, https://www.sec.gov/files/sec_strategic_plan_fy22-fy26_draft.pdf.

⁷ OPM, 2021 Guide to Telework and Remote Work in the Federal Government (Nov. 2021), <https://www.telework.gov/guidance-legislation/telework-guidance/telework-guide/guide-to-telework-in-the-federal-government.pdf>.

caliber workforce, . . . , increasing productivity, and enhancing the work/life balance of employees.”⁸ The industry has the same capabilities to fulfill its regulatory obligations and likewise offer flexible work arrangements to recruit and retain the most qualified workforce necessary to investor protection.

B. The Primary Impact of the Proposal

The primary impact of the Proposal would be that most firms could continue leveraging technology to conduct off-site inspections, provided that their risk assessments support such inspections, and they meet the requirements of the pilot. Absent this change, when the temporary inspection relief under FINRA Rule 3110.17 expires at the end of the year, firms would need to choose between either forcing their entire workforce back in the office to reduce the level of required inspections to pre-pandemic levels, thereby risking loss of key talent in a difficult labor market, or face exponentially increasing compliance burdens by conducting on-site inspections of more locations required to be inspected as a result of alternative work arrangements. For many firms, this could mean hundreds or thousands more locations to inspect. Notwithstanding their technological capabilities and even size, firms do not have the staff to conduct such a substantial and sudden increase in the volume of on-site inspections, let alone the time to recruit and train qualified individuals to meet this demand. The effect would be perverse to investor protection. Moreover, many of these locations do not engage in activities that present material risk of misconduct or harm, such that remote inspections would be ineffective, and as explained in Section IV below, would, and should, not be subject to inspection but for severely outdated rules and guidance.

C. A Step Towards Modernization

An antiquated and rigid regulatory regime does not lean into investor protection, which is diminished when regulations do not evolve and leverage new technologies. The SEC and FINRA both regularly review their respective rulebooks to determine if their rules need to be updated or rescinded.⁹ The Proposal is another step in this continual process of ensuring that the rules that govern our financial services industry are not stale, leverage modern processes and technologies, and, therefore, are best positioned to protect investors. As Chair Gensler has said:

No regulation can be static in a dynamic society. . . . Markets and business models have long evolved in response to new technologies; as Bob Birnbaum’s team noted, they are “dynamic.” I believe that innovation can bring greater access, efficiency, and innovation to our capital markets, as well as economic growth.¹⁰

The North American Securities Administrators Association (“NASAA”) also acknowledged, “. . . much [h]as changed over 100 years and NASAA and its members continue to adapt to changing times. Nowhere is this more evident than in NASAA’s work toward its goal of leveraging technology to enhance

⁸ See MD Telework Policy (Post Pandemic) (eff. Apr. 14, 2021), <https://dbm.maryland.gov/employees/Documents/telework/Telework%20Policy%20Post%20Pandemic%20April%2014%202021.pdf>.

⁹ See Securities Act Release No. 6323, 46 F.R. 33287 (June 29, 1981) (stating “[a]lthough 5 U.S.C. 610(a) requires an agency to publish a periodic review plan which applies only to those rules which have or will have a significant economic impact on a substantial number of small entities, the Commission’s plan generally provides for the review of a much broader class of rules”) and FINRA retrospective rule review program, description available at <https://www.finra.org/about/finra-360/progress-report/retrospective-rule-review>.

¹⁰ See SEC, Chair Gensler, Prepared Remarks: “Dynamic Regulation for a Dynamic Society” Before the Exchequer Club of Washington, D.C. (Jan. 19, 2022) (quoting Robert Birnbaum), <https://www.sec.gov/news/speech/gensler-dynamic-regulation-20220119>.

regulatory efficiencies and strengthen investor protection.”¹² Further and on point, the SEC’s Asset Management Advisory Committee recommended modernizing FINRA rules to account for technology, including Rule 3110’s inspection requirement to provide firms the “...flexibility to conduct remote technology-assisted inspections.”¹³

SIFMA applauds FINRA’s efforts here and more broadly to review and update its rules, guidance, and interpretations post-pandemic. The revisions under the Proposal exemplify the benefits of FINRA’s rule review process when it incorporates a studied approach that accounts for the real-world implications of regulations without compromising important investor protections and industry standards. SIFMA encourages FINRA to consider additional changes consistent with the objectives underlying the Proposal, including the areas highlighted in this letter and in our prior letters on these subjects.¹⁴

II. SIFMA’s Support of the Proposal

SIFMA supports the Proposal. Simply put, the pilot is reasonably designed and will allow FINRA and other regulators to properly assess the viability of modernized rule allowing for risk-based remote inspections.

A. The Industry Values Onsite Inspections

The Proposal does not forebode a wholesale abdication of onsite inspections by industry. Rather, the pilot allows an industry, facing an exponential increase in locations subject to inspection resulting from a dispersed workforce, to not only retain that workforce, but also demonstrate that technology can be used to perform required inspections of certain lower-risk locations remotely.

Like Chair Gensler has said, remote inspections (examinations in the SEC’s case) are valuable tool, but the industry agrees with him that they do not replace onsite inspections, which continue to provide value to firms from a compliance and relationship perspective.¹⁵ Chair Gensler has also found remote examinations allowed the staff to be productive, a view shared as well by the industry with respect to their own inspections.¹⁶ Technology has its benefits and can be deployed effectively in lower risk situations. As firms of all sizes have told us, 80 to 85 percent of their inspections are conducted in preparatory work utilizing the firm’s surveillance systems and other technologies. Moreover, they have told us that they can more easily adjust

¹² 2019 NASAA Report: Moving Forward to Protect Investors, at p. 4, <https://www.nasaa.org/wp-content/uploads/2021/10/2019-Activity-Report-FINAL.pdf>.

¹³ SEC Asset Management Advisory Committee Preliminary Recommendations of Operations Panel Regarding COVID-19 Operational Issues (Nov. 5, 2020), <https://www.sec.gov/spotlight/amac/preliminary-recommendations-of-the-operations-panel-regarding-covid-19-operational-issues.pdf>.

¹⁴ See SIFMA Comment on Regulatory Notice 17-38 (Jan. 12, 2018), https://www.finra.org/sites/default/files/notice_comment_file_ref/17-38_SIFMA_comment.pdf; SIFMA Comment on SR-FINRA-2020-019 (July 28, 2020), <https://www.sec.gov/comments/sr-finra-2020-019/srfinra2020019-7488707-221392.pdf>; Comment on FINRA Regulatory Notice 20-42 (Feb. 16, 2021), <https://www.finra.org/sites/default/files/NoticeComment/SIFMA%20%5BKevin%20Zambrowicz%5D%20-%20FINRA%2020-42%20COVID-19%20Impact%20SIFMA%20Comment%20Letter%20Final%20as%20Filed%20with%20FINRA%20on%20%20%2016%202021%20Zambrowicz.pdf>; and Comment on SR-FINRA-2022-001 (Feb. 16, 2022), <https://www.sec.gov/comments/sr-finra-2022-001/srfinra2022001-20116268-267910.pdf>.

¹⁵ See, Testimony at Hearing before the Subcommittee on Financial Services and General Government U.S. House Appropriations Committee (May 17, 2022), <https://www.sec.gov/news/testimony/gensler-testimony-fsgg-subcommittee>.

¹⁶ *Id.* In addition, NASAA reported that most of its members will continue, like the industry, to use a combination of onsite and remote exams in 2022, NASAA 2022 Investment Adviser Section Annual Report (Apr. 2022), <https://www.nasaa.org/wp-content/uploads/2022/06/2022-IA-Section-Report-FINAL-updated-05192022.pdf>.

to unforeseen circumstances that may arise when conducting onsite inspections. These include such things as medical or other family emergencies, illnesses by office or inspection staff, logistical scheduling or travel challenges, and individuals not being present during unannounced inspections. Firms could reschedule and conduct inspections remotely, provided their risk assessment support it, rather than putting additional resources into a second onsite inspection.

Whether participating in the pilot or not, we must emphasize that the industry will continue to perform onsite inspections not only to meet their regulatory obligations and the pilot's requirements, but also from a sound business and compliance perspective.

B. Inspections Are One Component of a Supervisory Program

As SIFMA has noted in previous comment letters on proposed amendments to Rule 3110, the inspection requirement of FINRA Rule 3110(c) is but a single element of a broader regulatory requirement to establish, maintain, and update a supervisory and controls program that is unique to each firm's business operations. On a daily basis, many departments (e.g., compliance, internal audit, legal, surveillance, and risk management), people, and systems are constantly monitoring for compliance with the securities laws. An annual or periodic inspection, while important, by comparison is a static point in time. The emphasis placed on onsite inspections fails to fully recognize constant surveillance.

The pilot program merely proposes, after careful assessment of the data by FINRA, to modernize one element of this overall supervisory and compliance program requirement. This is neither new, as FINRA proposed to modernize this requirement in 2017, nor particularly rushed given the industry has successfully performed remote inspections pursuant to Rule 3110.17, as FINRA recognizes,¹⁷ not to mention the many conversations among stakeholders. This informal pilot program of sorts has demonstrated that the industry overall can properly inspect its various locations, registered representatives, and lines of business from any work location without compromising our commitment to investor protection. But if the fully remote posture during the pandemic does not assuage concerns, the pilot provides for onsite inspections according to a participant's risk assessment.

C. The Standard is Reasonableness

There will always be bad actors in society and no sector, including the securities industry, is immune to their misconduct. FINRA's supervision rule does not presuppose that firms, or the use of technology, can guarantee compliant behavior. Recognizing this impossibility, FINRA's supervision rule is based on reasonableness: "Each member shall establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules." We assert that a pilot program allowing qualifying firms to perform remote inspections of lower risk locations, subject to conditions and mandatory reporting, is reasonable and can be part of a reasonably designed supervisory program.

¹⁷ *Supra* note 2 at 50153 (stating, "FINRA adopted temporary Rule 3110.17 in late 2020 and the temporary rule has been extended twice since. Hence, as of June 2022, member firms have been able to conduct remote inspections for 18 months. FINRA staff considered findings from FINRA's examination of member firms and their branch locations that took place in between 2018 and 2021. This preliminary review found no significant departures relative to pre-pandemic examination results.").

D. The Pilot is Reasonably Designed

The Proposal contains significant enhancements to test the above assertion, not only requiring firms to perform and justify their risk assessments supporting the performance of off-site inspections of certain locations, but also providing the SEC and FINRA with reportable data – data that supplements FINRA’s and the SEC’s own examination efforts – to assess the pilot’s success or failure. We believe, based on the past two years, that the data will demonstrate off-site inspections result in no loss to investor protection and this proposal should not be disapproved. It is a reasonably designed pilot that provides regulators the opportunity to assess the success of remote inspections in a structured manner and hopefully update severely outdated guidance that does not reflect significant changes in technology and the workforce.¹⁹

III. Simultaneous Consideration of the Proposal, Residential Supervisory Location Proposal, and Expiration of Rule 3110.17

SIFMA encourages the SEC to consider the Proposal in conjunction with FINRA’s related proposal on Residential Supervisory Locations (“RSL”) and approve both simultaneously given their interconnectivity.²⁰ This coordination is key given that one of the core aspects of the pilot program is data collection on inspections that is segregated by, and dependent on, an office’s classification as an Office of Supervisory Jurisdiction (“OSJ”), a supervisory branch office, a non-supervisory branch office, or a non-branch location.²¹ As such, to avoid throwing off the results of the pilot program, members will need clear guidance on whether a particular residence needs to be classified as an OSJ or a non-branch RSL.

In addition, the proposed pilot program is designed to provide an orderly transition from the temporary relief provided by Rule 3110.17. It would be ideal to simultaneously approve both proposals with an effective date on or before the December 31, 2022 sunset of Rule 3110.17. Any gaps between the two would result in significant regulatory uncertainty and operational burdens. If the SEC believes this timeline cannot be met, then SIFMA requests that the SEC consider extending Rule 3110.17 until the pilot and RSL proposals are approved and become effective. Any such extension should be granted with sufficient advance notice to provide firms with clarity on their regulatory obligations.

IV. SIFMA Encourages a Continued Dialogue with the SEC, FINRA, and NASAA on Modernization Efforts

SIFMA commends FINRA for recognizing that its rules can be modernized without sacrificing the paramount goal: investor protection, as demonstrated by the Proposal. The competitiveness and viability of the securities industry vis-à-vis other industries that offer greater workforce flexibility is at stake. Having a distributed workforce that performs the functions and services of a company from various alternative locations is not a new concept. Many industries used this model prior to the pandemic. Management techniques, supervisory systems, and operational functionalities have evolved over years to accommodate this mode of working and interacting. Technology, in particular, has created virtual offices where teams are

¹⁹ Supervisory guidance from the SEC dates to 2004. See SEC Staff Legal Bulletin 17 (Mar. 19, 2004), <https://www.sec.gov/tm/staff-legal-bulletin-17-remote-office-supervision>.

²⁰ 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>.

²¹ See proposed rule 3110.18(f)(1) (“a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations...”).

never truly separate from each other or their supervisors. We believe that this Proposal is one step in the right direction, and we welcome a dialogue with the SEC, FINRA, NASAA, and other stakeholders on how rules and regulations can adapt to the ever-changing landscape of the industry. We are especially supportive of the shifting focus from arbitrary location-based rules to a more risk-based approach.

In the adopting release for residential exclusions to the FINRA's branch office definition, the SEC noted:

Given the continued advances in technology used to conduct and monitor businesses and changes in the structure of broker-dealers and in the lifestyles and work habits of the workforce, the Commission believes it is reasonable and appropriate for NASD to reexamine how it determines whether business locations need to be registered as branch offices of broker-dealer members.²²

This direction from the SEC is applicable to FINRA's RSL proposal, but it should also guide the conversation here, and the one to be had over whether locations currently subject to the inspection requirement (whether it be one or three years) warrant inspection where they do not engage in activities that present material risk of misconduct or harm. For example, locations with permissively registered individuals; locations that are established solely for customer service or back-office type functions where no sales activities are conducted; locations where the only supervisory activities carried out do not implicate the same level of risk as locations with conduct that requires further regulatory scrutiny; and investment bankers that do not keep hard copy documents in their home offices and whom are often on the road. In line with our previous suggestions, inspections should only be mandatory for locations where firm personnel meet with customers, where the firm holds customer securities or funds, or any other locations that a firm determines after conducting a risk-based analysis (*e.g.*, a location with personnel subject to heightened supervision).²³

In order to implement risk-based inspection scheduling, we recommend that FINRA consider future updates to remove the annual requirement of FINRA Rule 3110.12 and the FINRA Rule 3110.13 presumption that such locations require inspection at least every three years in favor of a risk-based schedule. Risk factors weighed by firms, such as business conducted, access to firm books and records, heightened supervision of certain persons, and access to firm capital, could be documented. This process would allow for greater flexibility in handling supervision of lower risk areas of firm business without increasing risk of customer harm and would help firms efficiently utilize compliance staff and resources associated with more employees increasingly working from alternative work locations and increased volumes of locations and inspections. We also ask that any risk-based schedule should not have minimum requirements that exceed current minimum inspection schedule requirements.

V. Conclusion

SIFMA appreciates the opportunity to comment on the Proposal. Given that off-site inspections have been working well – nothing to the contrary has been expressed by regulators, we think it is prudent for the SEC to support FINRA's proposed rule relating to its Remote Inspections Pilot Program. We appreciate you taking into consideration our comments and we look forward to engaging with you on this effort. If you have any questions or require further information with respect our comments, please do not

²² Order Approving Proposed Rule Change and Amendment Nos. 1, 2, 3, 4, 5 and 6 Thereto Relating to Proposed Uniform Definition of "Branch Office" Under NASD Rule 3010(g)(2), SR-NASD-2003-104, Release No. 34-52403 (Sept. 9, 2005).

²³ *Supra* note 14.

hesitate to contact the undersigned or SIFMA's outside counsel, Marlon Q. Paz or Donald Thompson of Latham & Watkins LLP, at [REDACTED].

Very truly yours,

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