



Mark Quinn  
DIRECTOR OF REGULATORY AFFAIRS

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

December 7, 2022

Ms. Sherry R. Haywood  
Assistant 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. 34-96297:  
Proposed Amendments to FINRA Rule 3110**

Dear Ms. Haywood:

Cetera Financial Group, Inc. (“Cetera”) appreciates the opportunity to submit the following comments with respect to a proposal by the Financial Industry Regulatory Authority Inc. (“FINRA”) to amend FINRA Rule 3110 by adding Supplementary Material 3110.18. The proposed change would establish a pilot program under which FINRA member firms would be permitted to perform inspections of branch 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 four FINRA member firms with more than 8,000 registered representatives, doing business in all 50 states. This issue is of considerable importance to us and all other FINRA member firms, but also has important ramifications for both FINRA and the investing public.

We have previously submitted comments with respect to the Proposal. We will reiterate and expand upon some of them, but in summary, the addition of Supplementary Material .18 to Rule 3110 is a well-thought-out initiative, and we support it in both letter and spirit. Adoption of the Proposal will allow FINRA and member firms to determine if performing branch office inspections remotely under specified circumstances will promote more effective supervision and oversight. The pilot program will deliver real-time data that FINRA can use to evaluate both the efficacy of this approach and how it might otherwise assist in FINRA’s broader mission of investor protection.

We note that some commenters have objected to adoption of the Proposal, particularly with respect to the three-year period proposed for the pilot program. We will respond to some of these comments at a later date, but we suggest that many of them arise out of misconceptions about how supervision and oversight of registered representatives and sales practice activities are performed in the securities industry. A fuller understanding demonstrates that the Proposal will benefit all of the affected constituents, including investors, FINRA, and member firms.

FINRA has described the background and rationale behind the proposed three-year pilot program very comprehensively in its filing with the Commission, and has taken a well-reasoned approach that notes the benefits of modernizing the framework for supervision of all business activities by member firms. The securities industry has moved steadily away from paper-based, in-person supervision processes toward a more sophisticated and effective regime that relies much more on the use of electronic technology. This trend has occurred for several reasons: They include the growth of the industry, increase in the number of investors and customer accounts, the proliferation of new investment products, and the wide-scale adoption of electronic communication methods 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 will objectively demonstrate that there is no reduction in investor protection if these changes are implemented.

### **Current Requirements of FINRA Rule 3110**

FINRA Rule 3110(c) currently includes a provision requiring all member firms to perform in-person inspections of office locations on a prescribed schedule. It specifies that every Office of Supervisory Jurisdiction (“OSJ”) be inspected at least once per year, that 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 conducted by the firm.

### **The Impact of the COVID-19 Pandemic**

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. Recognizing the scope and potential duration of the pandemic, FINRA adopted temporary changes to Rule 3110, allowing branch office inspections to be performed remotely. That relief has been extended on multiple occasions, and is currently in effect until December 31, 2023.<sup>1</sup>

The COVID-19 pandemic appears to have largely abated, but it brought about significant changes in how FINRA member firms perform many activities, including oversight and supervision of sales practices. Most firms successfully reoriented their operations to allow workers to operate remotely, and quickly shifted to performing branch inspections remotely. We

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<sup>1</sup> See SEC File No. SR-2022-030. (October 31, 2022.)

will discuss this in more detail below, but the necessity to perform branch inspections remotely for nearly three years has established that the results have been substantially equivalent to those obtained through in-person inspections.

### **Comments on the Proposal**

**1. The Proposal is representative of broader and long-needed changes in regulatory standards and 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.

The adoption of new technological capabilities has allowed firms to more effectively deploy their supervision and compliance resources. For example, in the 1990's, 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. Today the vast majority of communications between representatives and customers is electronic. This has allowed FINRA members to utilize technology to 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 also note that even prior to the onset of the COVID-19 pandemic, both FINRA and the SEC had significantly changed their own practices in conducting examinations of broker-dealers. Twenty years ago, a typical FINRA or SEC examination consisted of staff examiners spending several weeks onsite at the firm, reviewing documents and speaking with employees and representatives. This regime has changed substantially. Instead of spending weeks onsite at the firm, SEC or FINRA staff 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 them to spend more than a few days physically present at the firm's offices during an examination. Since the onset of the COVID-19 pandemic, we do not believe that either FINRA or the SEC has sent examination staff members to visit firms in person except under truly unusual circumstances.

Both agencies adopted this approach after considering its effectiveness and consistency with their mission of investor protection. They have clearly 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 benefits from the rare occasions in which an in-person inspection uncovers evidence of wrongful conduct are more than offset by greater efficiencies achieved by performing most of that 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 are only one of the many elements in an effective supervisory system.**

Branch inspections, whether in-person or remote, are only a single element of an effective supervisory system. With the evolution of electronic oversight capabilities, branch inspections have become a less significant element of the supervision process than they may once have been. 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 in many cases customer records are not maintained in the branch. Offices of this type present lower risk profiles for the firm. Performing regular physical examinations of these locations diverts scarce supervision and compliance resources from locations 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 method 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 elect to 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 an appropriate first step.

FINRA did not seek public comment on the Proposal prior to submitting it to the SEC. We believe that this was due in part the pending expiration of the temporary relief provided in Supplementary Material .17 to FINRA Rule 3110, but also reflects the fact that FINRA previously sought comments regarding the experience

of both member firms and others in dealing with the COVID-19 pandemic.<sup>2</sup> FINRA received submissions from a diverse group of commentators, including members of the public and investor advocates. Some of the comments submitted by FINRA member firms refer to their experience with remote branch inspections, and several noted that the findings in those inspections, in both quantity and severity, were very similar to their experience with in-person inspections. It may be difficult to apply our experience to those of other firms, but the Cetera broker-dealers have conducted nearly 5,000 remote branch inspections from March 2020 through the present. Our experience indicates that both the frequency and severity of findings was very similar across in-person and remote inspections.

It has been suggested by some commentators that in-person branch office inspections have a unique value because they offer the opportunity to detect wrongful conduct 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 meaningless as a criterion in deciding whether or not to adopt the Proposal. Cetera conducted more than 3,000 in-person branch inspections during the period from 2017 through 2019, the most recent period for which data is available. We were able to locate only a small number of instances in which the type of wrongful conduct that could only be identified in person was first detected during a branch inspection, and believe that the conduct at issue would have been uncovered 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 individuals vastly outnumbers issues identified during in-person 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 help them 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.

**4. Resources for supervision and oversight are finite and should be focused in areas that yield the greatest impact.**

The absolute cost of supervision and compliance and the percentage of FINRA member firm revenues devoted to those activities have both risen steadily over the

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<sup>2</sup> See FINRA Regulatory Notice 20-42 (December 16, 2020).

past 20 years. Cetera understands and embraces this fact. Investments in supervision and compliance programs are necessary to protect investors, and yield material benefits by improving outcomes for customers and enhancing the reputation of both FINRA members and the securities industry in general. We are not suggesting that member firms should be given carte blanche to reduce their spending on supervision or eliminate all in-person branch inspections if the Proposal is adopted. FINRA has long premised its' rules on the concept that supervisory oversight must be based on processes that are reasonable in consideration of all of the circumstances, and nothing in the Proposal would change that. Some commenters have suggested that if the Proposal is adopted, member firms may no longer perform any branch inspections in person. That is theoretically possible, but in all but truly unusual instances, we do not believe that this approach would meet the standard for reasonableness that is inherent in all principles-based FINRA rules. The Proposal requires that member firms undertake a review of their business and processes to determine which office locations merit in-person inspections and which do not. It would be a rare firm that could justify conducting all inspections remotely, and FINRA has a process to address that if it occurs. The Proposal simply gives firms a better ability to determine how resources should be allocated. The pilot program will allow both FINRA and member firms to objectively establish whether applying resources to other supervision methods will yield greater benefits than if they are devoted to in-person branch inspections.

Cetera has not performed a significant number of in-person branch inspections since 2020. This reduced certain travel and related expenses, but our overall expenditures on supervision and compliance programs have increased over that time. The question is not whether an appropriate level of supervision and oversight will occur if the Proposal is adopted. FINRA rules require all member firms to 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 support that objective while giving broker-dealers the flexibility to focus on the branch offices, representatives, and activities that they believe merit the most attention.

**5. The Proposal contains significant safeguards to assure investor protection.**

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

- The pilot program may not be utilized by FINRA member firms that are subject to the provisions of FINRA Rules 4111 and 3170. Both rules apply restrictions on the activities of some member firms under specified circumstances. Those firms would not be eligible to participate. The Proposal would also require in-person inspection of locations which house individuals

subject to heightened supervision, statutory disqualification, or who have been involved in events that are reportable on the Forms U4 of the individual representatives.

We have noted above that in-person branch inspections are not necessarily more useful than remote versions as part of the overall supervision effort of FINRA member firms. We do not believe it can be established that in-person contact identifies unauthorized activities or violations of industry regulations more effectively than remote inspections in conjunction with an effective supervisory system. FINRA member firms that are subject to the provisions of FINRA Rules 3170 and 4111 have been deemed to have an inability or lack of willingness to comply with standards of conduct that the rest of the industry accepts and embraces. At least to some extent, eligibility to participate in the pilot program envisioned by Proposal should be viewed as a privilege, and firms subject to restrictions on their operations may not necessarily be entitled to the benefit of the doubt. That being said, the specific issues that Rules 3170 and 4111 are designed to address are not particularly related to activities that are central to physical branch office inspections. Not allowing firms subject to unrelated restrictions to participate in the pilot program may not yield any material benefit to investors, and may actually have a negative effect by preventing firms from adopting processes that would strengthen their overall supervision programs.

- The Proposal requires firms relying on the provisions of Supplementary Material .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.

As we have noted above, some commenters have suggested 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 that Cetera has no current intention of doing so. We have maintained our entire staff of branch examiners during the COVID-19 pandemic, 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.

**6. The Proposal should be considered in conjunction with and adopted at the same time as FINRA's proposed rule change to adopt Supplementary Material .19 under Rule 3110.**

FINRA has separately proposed to adopt Supplementary Material .19 to Rule 3110. Among other things, that proposal would redefine the circumstances under which a branch location is deemed an OSJ. While that proposed change is not formally connected to the Proposal, we believe that these two issues are so closely related that they should be considered and adopted at the same time. Under the current version of Rule 3110, OSJ locations are required to be inspected in-person at least once per year. This is largely reflective of a view that the specific activities, including the performance of supervisory functions, made these locations inherently more in need of frequent physical contact. As we have discussed above, supervision of sales practices and other activities performed by representatives has evolved significantly since the current definition of OSJ was adopted. Activities that may have required physical presence in a paper-based world are now routinely and effectively performed electronically from remote locations. If the Proposal is adopted, FINRA member firms would be required to design and implement risk-based systems to evaluate which branch locations would be physically inspected in order to rely on it. Classification of a branch location as an OSJ should be solely determinative of whether and how often an inspection should be done in-person, but it would be a significant factor in that analysis and could lead to undue emphasis by FINRA members on performing in-person inspections at OSJ locations, we do not believe this is warranted, and militates in favor of adopting Supplementary Material .18 and .19 at the same time.

**7. Three years is an appropriate timeframe for the pilot program.**

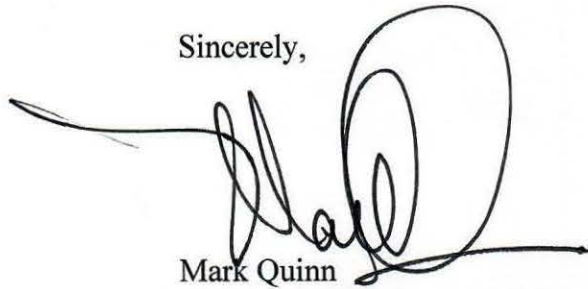
FINRA has proposed a pilot program permitting remote office inspections for a three-year period. Some commenters have suggested that this is too long, and that one year would be a more appropriate term. We will not suggest that there is a magic number of years, and the Proposal should be adopted regardless of the term of the pilot program. That being said, we do not believe that one year will be enough time for FINRA to collect and analyze the data that it will utilize to determine the efficacy of a permanent rule change. It is reasonable to assume that a large number of member firms would participate in any pilot program, which would create a large volume of data for FINRA to analyze. In an exercise of this type and scale, it is likely that FINRA will review the data it receives initially and decide that additional or different elements would be useful or necessary. In order to make the best and most informed decision, FINRA should be given every reasonable opportunity to collect useful data. We do not believe that a one-year pilot program allows for mid-course corrections that are likely to be required. Three years seems like a much more realistic timeframe.



Ms. Sherry R. Haywood  
December 7, 2022  
Page 9 of 9

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,

A handwritten signature in black ink, appearing to read 'Mark Quinn', with a large, stylized initial 'Q' and a long horizontal flourish extending to the left.

Mark Quinn  
Director of Regulatory Affairs  
Cetera Financial Group