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VOICE OF INDEPENDENT
FINANCIAL SERVICES
FIRMS AND INDEPENDENT
FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

January 12, 2023

Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: SR-FINRA-2022-021: Notice of Partial Amendment No. 1 to Proposed Rule Change To Adopt Supplementary Material .18 (Remote Inspections Pilot Program) Under FINRA Rule 3110 (Supervision)

Dear Secretary:

On December 22, 2022, the Securities and Exchange Commission (“SEC” or “Commission”) published the Financial Industry Regulatory Authority, Inc.’s (“FINRA”) Notice of Partial Amendment No. 1 to Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) Under FINRA Rule 3110 (Supervision) (“Amended Pilot Program Proposal”).¹ On July 28, 2022, FINRA filed with the SEC a proposed rule to adopt a voluntary, three-year remote inspection pilot program to allow member firms to elect to fulfill their obligation under Rule 3110(c) (Internal Inspections) by conducting inspections of some or all branch offices and locations remotely without an on-site visit to such office or location, subject to specified terms. On August 15, 2022, the SEC published this proposed rule change in the Federal Register for public comment.² Approximately thirty comments were submitted, including our comment letter.³ We appreciate the opportunity to comment on the Amended Pilot Program Proposal and we continue to support FINRA’s proposed Remote Inspections Pilot Program. We offer select comments below based on the amendments to the pilot program proposal.

Background on FSI Members

FSI is an advocacy association comprised of members from the independent financial services industry. The independent financial services community has been an important and active

¹ Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; SR-FINRA-2022-021: Notice of Partial Amendment No. 1 to Proposed Rule Change To Adopt Supplementary Material .18 (Remote Inspections Pilot Program) Under FINRA Rule 3110 (Supervision), available at <https://www.federalregister.gov/documents/2022/12/22/2022-27787/self-regulatory-organizations-financial-industry-regulatory-authority-inc-notice-of-partial#footnote-10-p78737>

² Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change To Adopt Supplementary Material .18 (Remote Inspections Pilot Program) Under FINRA Rule 3110 (Supervision) available at <https://www.federalregister.gov/documents/2022/08/15/2022-17428/self-regulatory-organizations-financial-industry-regulatory-authority-inc-notice-of-filing-of-a>

³ FSI Comment on SR-FINRA-2022-021: Notice of Filing of a Proposed Rule Change To Adopt Supplementary Material .18 (Remote Inspections Pilot Program) Under FINRA Rule 3110 (Supervision), available at <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20138367-308400.pdf>

part of the lives of American investors for more than 40 years. In the US, there are more than 160,000 independent financial advisors, which account for approximately 52 percent of all producing registered representatives.⁴ These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (“IBD”).⁵ FSI’s IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions.

FSI members make substantial contributions to our nation’s economy. According to Oxford Economics, FSI members nationwide generate \$35.7 billion in economic activity. This activity, in turn, supports 408,743 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly \$7.2 billion annually to federal, state, and local government taxes.⁶

Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI members and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

Discussion

While FSI generally supports the Amended Pilot Program Proposal for the reasons outlined in previous comment letter submissions, we provide limited comments on certain of the proposed amendments to the remote inspections pilot. As previously noted, FSI believes it is beneficial to have a pilot program designed in a manner that enables and encourages firms, across a representative sample of business models and sizes, to participate in the program to enable regulators to obtain sufficient data to continue to review the effectiveness of remote inspections. To the extent that the Amended Pilot Program Proposal adds additional restrictions and documentation requirements, firms may self-select out, resulting in a smaller data set available to regulators to review and analyze. Our members note, and submitted comments further suggest, that firm supervisory programs, more broadly, may become more effective when firms are able to efficiently deploy compliance resources. Reducing participation in this Pilot Program through overly restrictive criteria and requirements has the potential to limit the opportunity for regulators to observe the benefits of remote inspections and the way their use may better firms’ overall supervisory systems. FSI notes two areas that may benefit from further consideration.

1) Firm Level Eligibility Exclusions and Conditions: Violations of Rule 3110(c)

The Amended Pilot Program Proposal adds additional restrictions on eligibility to participate in the program. Of the six firm-level conditions on eligibility, the Amended Pilot Program Proposal adds that a firm cannot participate in (or must discontinue participating in) the remote

⁴ Cerulli Associates, Advisor Headcount 2016, on file with author.

⁵ The use of the term “financial advisor” or “advisor” in this letter is a reference to an individual who is a dually registered representative of a broker-dealer and an investment adviser representative of a registered investment adviser firm. The use of the term “investment adviser” or “adviser” in this letter is a reference to a firm or individual registered with the Securities and Exchange Commission (SEC) or state securities division as an investment adviser.

⁶ Oxford Economics for the Financial Services Institute, The Economic Impact of FSI’s Members (2020).

inspections pilot program, if, within the past three years, it has been found by the SEC or FINRA to have violated Rule 3110(c) (Internal Inspections). Through the course of routine examinations firms may be (or may have been) cited, for example through a Cautionary Action Letter, for minor violations, sometimes of technical aspects, of this rule. Inclusion of minor violations of Rule 3110(c) seems over-inclusive and different in nature to other criteria outlined (e.g., a firm becomes suspended by FINRA). Practically, a minor exam violation finding in this area that, mid-year, requires the firm to exit the remote inspections pilot program is likely to be more disruptive and harmful to the firm's supervisory and inspections program than protective to investors. FSI suggests a more narrowly tailored approach to exclusions. FSI suggests shortening the three-year lookback window and limiting the type and nature of Rule 3110(c) violations that evidence systemic failures, as opposed to minor deficiencies.

2) Risk Assessment and Documentation

FINRA proposes to amend proposed Rule 3110.18(b) by adding subpart (2) as follows:

(2) In conducting the risk assessment of each office or location in accordance with Rule 3110.18(b)(1), a member shall consider, among other things, the following in making their risk-based evaluation of each office or location: (A) the volume and nature of customer complaints; (B) the volume and nature of outside business activities, particularly investment-related; (C) the volume and complexity of products offered; (D) the nature of the customer base, including vulnerable adult investors; (E) whether associated persons are subject to heightened supervision; (F) failures by associated persons to comply with the member's written supervisory procedures; and (G) any recordkeeping violations. In addition, consistent with Rule 3110.12, members should conduct on-site inspections or make more frequent use of unannounced, on-site inspections for high-risk locations or where there are "red flags."

FINRA indicated that it expects a firm to carefully consider the proposed factors listed above and in Rule 3110.12 for its risk assessment. While this non-exhaustive list of factors to consider is useful, a firm's judgment in evaluating these factors should not be assessed through the benefit of hindsight and the presence of one (or even more than one) of these factors should not, *per se*, preclude a location from being subject to remote inspection. For example, a minor recordkeeping issue identified five years prior may not be particularly relevant considering all facts and circumstances. In addition, the presence of disclosed outside business activities, such as services offered through an affiliated registered investment adviser, does not seem consistent with the nature of other considerations outlined above. The basis for the suggestion that remote inspections would be less effective or higher risk based on this factor alone is unclear and this criterion would benefit from a more narrowly tailored approach. More generally, if FINRA disagrees with assessments made by firms, sharing those concerns through non-enforcement means in a manner that preserves the firm's ability to remain in the pilot would be superior to a more punitive approach.

Conclusion

With the considerations noted above, FINRA's three-year voluntary pilot program, with the investor protection safeguards built into the program's proposal, is well-positioned to facilitate the collection of additional information and data for study by the regulators. We continue to support

the SEC's and FINRA's efforts to modernize securities rules and regulations to reflect technological advances and an evolution to a geographically decentralized work force model.

FSI is committed to constructive engagement in the regulatory process and welcomes the opportunity to work with the SEC and FINRA on this and other regulatory efforts. Thank you for considering FSI's comments. Should you have any questions, please contact me at [REDACTED].

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. Bellaire". The signature is fluid and cursive, with a large initial "D" and "B".

David T. Bellaire, Esq.
Executive Vice President & General Counsel