



## PUBLIC INVESTORS ADVOCATE BAR ASSOCIATION

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April 26, 2023

Via Email Only @ [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Ms. Vanessa Countryman  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

File Number SR-FINRA-2023-006- Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) Under FINRA Rule 3110 (Supervision)

Dear Ms. Countryman:

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities litigation. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by the Securities and Exchange Commission ("SEC") relating to both investor protection and disclosure.

Pursuant to Rule of Practice 192(a) of the Securities and Exchange Commission, PIABA submits this comment to the SEC concerning FINRA's recent proposed rule change to amend FINRA Rule 3110 (Supervision). FINRA has filed proposed rule changes to FINRA Rule 3110 to add new Supplementary Material as section .19 (3110.19 – Residential Supervisory Location). The proposed amendment would allow a home office to be considered a residential supervisory location and then create rules and procedures for the supervision of same.

The proposed rule is substantially similar to the rule proposal FINRA filed with the SEC in July 2022, (SR-FINRA-2022-019) which was twice published for comment on August 2, 2022 and November 4, 2022. PIABA published two separate comment letters on August 23, 2022 and November 22, 2022 in response to that rule proposal asking the SEC to reject the rule proposal. As discussed in detail below, PIABA again submits this comment asking the SEC to reject this proposal.

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PIABA submits this comment because the bar association believes the amendment runs counter to FINRA's stated objective of investor protection. While it is understood that FINRA is attempting to change with the increased use of virtual technology, it leaves considerable opportunity for advisors working from home to skirt the rules and fosters new opportunities for those advisors to engage in sales abuses.

### **Background**

As a result of the Covid pandemic, regulators eased regulatory requirements to accommodate brokerage firm employees working at home. This effort included the introduction of new technologies to permit remote supervision. As part of the rationale for this proposal, FINRA states that it "believes that this [work from home] model will endure" and that there is a "growing expectation for workplace flexibility."<sup>1</sup> FINRA further states that this was an opportunity to "consider aspects of Rule 3110 that may benefit from modernization."<sup>2</sup>

While PIABA appreciates FINRA's desire to accommodate new ways of working, the accommodation cannot come at the expense of investor protection: the stated purpose of FINRA, the SEC and the securities laws themselves. As such, any sort of "work from home" accommodation must ensure that investor protection is not reduced in any way. Such accommodations are a privilege, not a right, and should only be permitted with sufficient safeguards, restrictions and limitations as to ensure that the brokerage industry and FINRA's investor protection ability is not degraded at all.

FINRA withdrew its prior 2022 rules proposal (SR-FINRA-2022-019) concerning establishing residential supervisory locations after receiving intense criticism from PIABA and particularly NASAA. FINRA has now re-filled a substantially similar rule proposal for residential supervisory locations that does contain some improvements from its prior rules proposal, but still fails to adequately protect investors and should therefore be rejected by the SEC.

### **Regular Periodic Schedule of Inspections (Once Every Three Years) is Insufficient**

Just as in FINRA's prior proposal, the current rule proposal is for residential supervisory locations to be on a regular periodic schedule of inspections, presumed to be every three years, rather than an annual schedule of inspections that branch office locations must utilize. PIABA believes this is a mistake that unnecessarily increases risks to investors.

In our prior comment letter, PIABA cited a host of regulatory actions involving brokers running "selling away" or Ponzi schemes from residential or remote (often one-broker) offices, including regulatory actions by both FINRA and the SEC which recognized that supervision of smaller branch offices presented "greater supervisory challenges" than traditional brokerage firm offices.<sup>3</sup> As such, it makes no sense to have a looser audit schedule for such locations.

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<sup>1</sup> 88 Fed. Reg. 20568, 20569 (April 6, 2023).

<sup>2</sup> *Id.*

<sup>3</sup> See PIABA Comment Letter to Vanessa Countryman, File No. SR-FINRA-2022-019 (November 22, 2022), pgs. 3-4.

FINRA argues that a firm's remote "surveillance and technology tools" will ensure firm's adequately supervise representatives and that investor protection is not degraded. However, this understates the issues firms face with remote supervision. As PIABA previously noted:

There are some things that technology cannot detect, but would be found with little difficulty through an in-person audit. For example, when an auditor visits the advisor's home office, the auditor can see their home, car, and other assets. Many firms' compliance procedures ask supervisors to gauge whether the advisor is leaving within their means (or at least, their legitimate commissions or compensation), and this cannot be done effectively remotely or through in person visits taking place every three years. Moreover, a remote inspection will not find evidence of files or other documents related to unapproved investments being recommended to customers (i.e., "selling away"). Our members have had cases where brokers sold unapproved investments with brochures and other offering documents in plain sight of their office. Obviously, a remote inspection would not uncover such problems.<sup>4</sup>

Accordingly, residential supervisory locations should at minimum be subject to annual in person audits, if not more frequent unannounced visits, rather than periodic inspections every three years.

### **Exclusions for Associated Persons with Multiple Customer Complaints or Arbitrations**

In response to criticism from NASAA, FINRA expanded the residential supervisory location ineligibility criteria to include instances where "one or more associated persons at such location is currently subject to, or has been notified in writing that it will be subject to, any investigation, proceeding, complaint or other action by the member, the SEC, an SRO, including FINRA, or state securities commission . . . alleging they have failed reasonable to supervise another person subject to their supervision."<sup>5</sup>

PIABA supports this expansion of the ineligibility criteria to preclude associated persons who have subject to failure to supervise complaints or investigations by securities regulators, as such individuals pose a further enhanced risk to investor protection. However, PIABA believes that FINRA should have expanded the ineligibility criteria even further to preclude associated persons who have been the subject of multiple customer complaints, consumer-initiated, investment-related arbitrations or civil litigation.

In our members' experience, customer complaints and/or consumer-initiated, investment-related arbitration and/or civil litigation claims are often the "canary in the coalmine" that are the first sign of problematic associated persons. Regulatory proceedings frequently begin after a customer complaint, arbitration or civil litigation U4 disclosure filing is made and can take many months or years to conclude. There is no reason to wait for formal regulatory action to prohibit associated

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<sup>4</sup> *Id.* at pgs. 2-3.

<sup>5</sup> 88 Fed. Reg. 20568, 20577 (April 6, 2023).

Ms. Vanessa A. Countryman

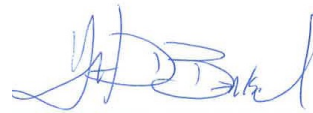
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persons with multiple complaints, arbitration or litigation claims from operating at a residential supervisory location. Rather, FINRA's investor protection mandate dictates that associated persons with multiple customer complaints and/or arbitration or civil litigation claims should be disqualified from operating at a residential supervisory location where supervision poses a greater challenge. As noted above, the ability to operate at a residential supervisory location should be a privilege, not a right. Thus, any supervisory or compliance doubts concerning an associated person must be resolved in favor of investor protection by precluding such individuals from operating at a residential supervisory location.

PIABA thanks the Commission and FINRA for the opportunity to comment on this proposal.

Very Truly Yours,



Hugh Berkson  
President, Public Investors Advocate Bar  
Association