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Sherry R. Haywood  
Assistant Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**RE: File No. SR-FINRA-2023-006: Notice of Filing of a Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision)**

Dear Ms. Haywood:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),<sup>1</sup> I am writing in response to U.S. Securities and Exchange Commission (“SEC” or the “Commission”) Release No. 34-97237, *Notice of Filing of a Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision)* (the “RSL Proposal”).<sup>2</sup> The RSL Proposal is a resubmission of a proposed rule change originally filed in 2022 (“2022 RSL Rule Filing”),<sup>3</sup> on which NASAA submitted two comment letters.<sup>4</sup> We reiterate and incorporate our previous comments on the 2022 RSL Rule Filing, and submit the following additional comments regarding the RSL Proposal.

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<sup>1</sup> Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, the U.S. Virgin Islands, and Guam. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

<sup>2</sup> The RSL Proposal is available at <https://www.sec.gov/rules/sro/finra/2023/34-97237.pdf>.

<sup>3</sup> See RSL Proposal at 2 n.5 (defining “2022 RSL Rule Filing”).

<sup>4</sup> Letter from Melanie Senter Lubin, NASAA President, to J. Matthew DeLesDernier, SEC Assistant Secretary, *Re: File Nos. SR-FINRA-2022-021 and SR-FINRA-2022-019* (“NASAA Comment Letter I”) (Aug. 23, 2022), <https://www.sec.gov/comments/sr-finra-2022-019/srfinra2022019-20137298-307861.pdf>; Letter from Andrew Hartnett, NASAA President, to J. Lynn Taylor, Assistant Secretary, *Re: File No. SR-FINRA-2022-019* (“NASAA Comment Letter II”) (Nov. 25, 2022), <https://www.sec.gov/comments/sr-finra-2022-019/srfinra2022019-20151667-320142.pdf>.

Overall, we acknowledge and appreciate the improvements made to the RSL Proposal since it was first proposed in 2022. However, we remain concerned that the RSL Proposal would not adequately ensure effective supervision and may put investors at risk. As such, the RSL Proposal should be further revised as described below before it can be considered appropriate for approval.

**I. NASAA supports key changes from the 2022 RSL Rule Filing.**

The RSL Proposal would treat a private residence at which an associated person engages in certain supervisory activities as a non-branch location, subject to certain conditions and criteria. The RSL Proposal is a step forward from the 2022 RSL Rule Filing in several respects, including revisions that are responsive to NASAA's previous comments. NASAA generally supports these revisions.

First, the RSL Proposal would require each member firm to provide FINRA with a list of the firm's RSLs on a quarterly basis through an electronic process.<sup>5</sup> FINRA notes in the RSL Proposal that it is "exploring ways to provide this information to state regulators in a practical format."<sup>6</sup> This requirement is critical to the ability not only of state securities regulators, but also of FINRA, to effectively oversee firms' important supervisory functions. We support this provision and look forward to working with FINRA to develop an appropriate mechanism to ensure that all regulators have access to this information.

Second, the RSL Proposal would provide that a location is ineligible for RSL status if, among other things, one or more associated persons at that location is subject to, or has been notified in writing that they will be subject to, an investigation or other regulatory action alleging failure to reasonably supervise others with a view to preventing violations of state securities laws.<sup>7</sup> As proposed in the 2022 RSL Rule Filing, this provision would have been limited to alleged failures to supervise to prevent violations of the *federal* securities laws. NASAA appreciates FINRA's reconsideration of its earlier refusal to include state securities laws in response to NASAA's initial commentary.<sup>8</sup> State securities laws are an important part of the regulatory framework and should not be treated differently with respect to assessments of regulatory and supervisory risks that the proposed ineligibility criteria are designed to address.

Third, and finally, the RSL Proposal would augment the recordkeeping-related conditions from the 2022 RSL Rule Filing to require that the firm have "prompt access" to its required books and records. As explained in our November 25, 2022 letter, the original proposed recordkeeping conditions were stated too loosely to be effective.<sup>9</sup> As proposed in the RSL Proposal, this requirement would better enable firms to supervise their associated persons centrally. It would

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<sup>5</sup> See Proposed Rule 3110.19(d).

<sup>6</sup> RSL Proposal at 43 n.108.

<sup>7</sup> See Proposed Rule 3110.19(c)(6).

<sup>8</sup> See NASAA Comment Letter I.

<sup>9</sup> NASAA Comment Letter II at 7.

also help protect against misappropriation and misuse of sensitive customer information. As such, we support this provision.

**II. Further revisions are needed to protect investors and ensure high standards of conduct within the securities industry.**

NASAA would support approval of the RSL Proposal with the following modifications.

First, the RSL Proposal should retain an annual inspection schedule for RSLs. One of the principal effects of the RSL Proposal would be to reduce the frequency of firms' supervisory inspections of these locations from annually to "presum[ably] . . . at least every three years."<sup>10</sup> NASAA understands, and we do not categorically oppose, FINRA's initiatives to adjust certain regulatory requirements to accommodate hybrid work arrangements, where appropriate. However, the purported benefits of hybrid working arrangements<sup>11</sup> must not come at the expense of investor protection, high standards of conduct in the securities industry, or close scrutiny of firms' activities.

As explained in our earlier comment letters regarding the 2022 RSL Rule Filing,<sup>12</sup> FINRA has not shown that supervisory functions present sufficiently "lower risk" to warrant loosening oversight of the individuals performing those functions. Although supervisory functions do not present the same kinds of risk as do sales activities, for example, the former are not "low risk" and are in fact an integral component of overall risk mitigation. Effective firm supervision of associated persons is a critical component of the broader investor protection framework under state and federal securities laws. Associated persons performing supervisory functions are intended to be a first line of defense, compliance, and risk mitigation within their firms. Lax or otherwise ineffective supervision can result in the failure to stop preventable harms before they occur, or even exacerbate harms that have already begun. Thus, it is exceptionally important that supervisory functions be subject to regular scrutiny by firms to ensure that they are operating effectively.

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<sup>10</sup> See Rule 3110.13.

<sup>11</sup> See, e.g., RSL Proposal at 51-53.

<sup>12</sup> See NASAA Comment Letters I and II.

In fact, FINRA has already determined through Rule 3110 that locations at which supervisory functions are performed must be inspected more frequently than offices or locations at which such functions are not performed.<sup>13</sup> Both FINRA and the SEC have long recognized that regular inspection is especially important for small, remote offices.<sup>14</sup> This is not a mere theoretical exercise, as less frequent inspections could result in failures to promptly identify supervisory lapses and tangible investor harms. Although FINRA emphasizes that “firms will continue to have an ongoing obligation to supervise the activities of each associated person in a manner reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules,”<sup>15</sup> it does not propose to require firms to enhance other supervisory components to address the likely shortfall that would come with less frequent onsite inspections.

FINRA also has not responded to similar concerns that we raised in our earlier comment letters on the 2022 RSL Rule Filing. Although the RSL Proposal generally discusses the increase in hybrid work arrangements as a result of the pandemic and the use of technological tools that may enable firms to conduct business and day-to-day supervision remotely, none of these developments have any bearing on the appropriate frequency or depth of scrutiny of supervisory activities. As such, proposed Rule 3110.19 should be revised to provide, consistent with Rule 3110(c)(1)(A), that each firm must inspect each RSL “at least annually (on a calendar-year basis).”

Second, proposed Rule 3110.19(c)(3) should be expanded to expressly include certain heightened supervisory plans imposed by firms.<sup>16</sup> In NASAA’s November 25, 2022 letter, we stated that a location at which an associated person is subject to a heightened supervisory plan “imposed by the member” should be categorically ineligible for RSL status under proposed Rule 3110.19. In response, FINRA noted that firms may “undertake additional supervisory measures” “out of an abundance of caution,” as part of the routine evaluation of their supervisory systems, and that NASAA’s approach “could disincentivize a firm from imposing its own heightened supervisory plan as part of effective supervision if the result was RSL ineligibility.”<sup>17</sup>

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<sup>13</sup> Compare FINRA Rule 3110(c)(1)(A) (requiring member firms to inspect offices of supervisory jurisdiction (“OSJs”) and supervisory branches “at least annually”) with 3110(c)(1)(B) (requiring member firms to inspect non-supervisory branches and non-branch locations “at least every three years”) and 3110.13 (noting that the three-year period is a “general presumption” and that member firms may establish “longer periodic inspection schedule[s]”).

<sup>14</sup> See, e.g., FINRA, Regulatory Notice 14-10: Consolidated Supervision Rules (Mar. 2014), <https://www.finra.org/sites/default/files/NoticeDocument/p465940.pdf> (reminding firms to “conduct *focused reviews* of one-person OSJ locations”) (emphasis added); SEC Division of Market Regulation, Staff Legal Bulletin No. 17: Remote Office Supervision (Mar. 19, 2004), <https://www.sec.gov/tm/staff-legal-bulletin-17-remote-office-supervision> (“reminding broker-dealers that small, remote offices require *vigilant* supervision”) (emphasis added).

<sup>15</sup> See RSL Proposal at 45.

<sup>16</sup> See Rule 3110.19(c)(3) (addressing “heightened supervisory plan[s] under the rules of the SEC, FINRA or state regulatory agency”).

<sup>17</sup> FINRA Response to Comments Re: 2022 RSL Rule Filing, 4-5 (Dec. 9, 2022), <https://www.sec.gov/comments/sr-finra-2022-019/srfinra2022019-20152571-320400.pdf>; see also RSL Proposal at 42 n.103.

While we believe that acting on such a “disincentive” could in many situations constitute a violation of applicable laws and rules pertaining to supervision, we understand FINRA’s reasoning. However, it is important that proposed Rule 3110.19 address circumstances in which heightened supervision is necessary, regardless of whether there is a formal regulatory action or determination. In particular, we are concerned that some firms may impose their own heightened supervisory plan in lieu of a formal regulatory action or order, or in response to a regulatory examination. Such circumstances raise the same concerns as regulator-mandated plans and should be addressed accordingly. As such, proposed Rule 3110.19(c)(3) should be revised (**as shown in red**) to preclude RSL status where an associated person “is subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or state regulatory agency, **or heightened supervision under a plan established by the member in connection with or in response to any such regulator’s recommendation or finding.**” We believe this change would appropriately balance both FINRA’s and NASAA’s concerns.

### **III. Conclusion**

The RSL Proposal is a significant improvement from the 2022 RSL Rule Filing, and NASAA supports the changes made in response to our previous comments. However, the RSL Proposal should not be approved without certain changes, detailed above. Since FINRA is proposing to loosen firms’ long-established supervisory obligations, it is imperative that the rules proposed to do so adequately account for the obvious and foreseeable risks.

Thank you for considering these views. NASAA looks forward to continuing to work with the Commission and FINRA in the shared mission to protect investors. Should you have questions, please contact either the undersigned or NASAA’s General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,



Andrew Hartnett  
NASAA President and  
Deputy Commissioner,  
Iowa Insurance Division