



April 27, 2023

**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 .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision); File No. SR-FINRA-2023-006; Release No. 34-97237***

Dear Ms. Countryman:

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> writes to express our concerns with FINRA’s proposed expansion of the ineligibility criteria in the re-proposal of Supplementary Material .19.<sup>2</sup> In particular, we are concerned about the expansion of the ineligibility criteria to include allegations of failure to supervise with a view to preventing violations of state laws and regulations. We appreciate the prodigious effort FINRA has put into this much-needed rule modernization and its careful consideration of comments by stakeholders. We continue to support wholeheartedly a personal residence exemption for supervisors that non-supervisory registered representatives have long enjoyed. This expansion, however, creates significant practical challenges and raises questions of fairness. We urge the SEC to reject this expansion.<sup>3</sup>

### **Background**

Under the new proposal, a supervisor would be ineligible to work at a Residential Supervisory Location (“RSL”) if they are currently subject, or receive written notice that they will be subject, to an investigation for failing to supervise another person with a view to preventing violations of securities

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<sup>1</sup> 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”).

<sup>2</sup> Proposal to Adopt Supplementary Material .19 (Residential Supervisory Location), 88 FR 20568 (Mar. 31, 2023), <https://www.govinfo.gov/content/pkg/FR-2023-04-06/pdf/2023-07145.pdf>.

<sup>3</sup> For the same reasons expressed in this letter, we urge the SEC to reject PIABA’s request that RSLs should be disqualified for unadjudicated matters. PIABA Comment Letter (Apr. 26, 2023), <https://www.sec.gov/comments/sr-finra-2023-006/srfinra2023006-20165110-334464.pdf>.

laws.<sup>4</sup> Under a previous iteration of the proposal, the ineligibility criteria did not include state securities laws because the Form U4 does not require disclosure of investigations by state securities regulators for failing to supervise. The Form U4 is the primary method that FINRA and the industry use to track investigations, regulatory actions, and other important updates to a registered representative's record. NASAA's request that state investigations be added to the ineligibility criteria was rejected by FINRA in the original proposal because it did not align with the provisions of the Form U4 and would therefore be difficult to track state investigations.<sup>5</sup> The original proposal's ineligibility criteria based on the Form U4 and the policy choices supporting it were sensible, manageable, and fair to supervisors.

### **Practical Challenges**

Even if the Form U4 was updated to require disclosure of state investigations and thus address the tracking issue FINRA has already highlighted and therefore reduce the risk of missing a notice, the practical challenges of the ineligibility criteria are greatly amplified beyond the original proposal.<sup>6</sup> FINRA previously rejected NASAA's request for good reason and we offer other, equally good reasons here.

Introduced for the first time are 50 different state standards for opening an investigation. One state can disqualify an RSL, without adjudication, simply by submitting notice of an investigation. This could become a significant operational concern for both the firm and the supervisor if he or she is recalled to an OSJ or home office far from their home, and particularly if dozens or hundreds of supervisors across the U.S. are subject to investigations by any number of state regulators at any one time. A firm may have reduced their office space in the post-COVID world and will have less OSJs or smaller OSJ offices where a supervisor could work during what is essentially a penalty period. The industry, along with FINRA and the SEC, are trying to adapt to a new work environment and create a more diverse and inclusive industry with workplace flexibility that attracts qualified individuals that are essential to investor protection. The RSL is a critical component to this effort and NASAA's position could undermine it.

Complicating matters, there may be overlapping investigations and uncertainty when an investigation closes without charges. States often charge violations of FINRA rules.<sup>7</sup> If FINRA is investigating the same conduct and ultimately determines not to charge a supervisor, will the states take that into consideration? Will state regulators provide timely notice when a supervisor is no longer subject to an investigation, or must they wait months or years and expend significant effort for a termination notice? In the meantime, they are penalized by an invariably drawn out and uncertain investigation. Unlike the states, the SEC, FINRA and other SROs have clear standards for opening an investigation that are well known to the industry, and the industry has established communication channels with their primary regulators to understand the nature and status of an investigation.

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<sup>4</sup> *Id.* at 20577.

<sup>5</sup> *Id.* at 20577-78.

<sup>6</sup> The expanded ineligibility criteria compound the practical challenges of the overly broad disqualification provision for less than one year of supervisory experience with the firm that SIFMA raised in the original proposal. For example, supervisors with years of supervisory experience are preventing from working from home their first year. *See* SIFMA Comment Letter (Aug. 23, 2022), <https://www.sec.gov/comments/sr-finra-2022-019/srfinra2022019-20137268-307822.pdf>.

<sup>7</sup> *Id.* at 20578.

### **Questions of Basic Fairness: Notice By Any One of 50 State Regulators is a Penalty**

Beyond the practical challenges, this expansion raises basic fairness and due process concerns. A core tenet of our judicial system, and society in general, is to not unduly prejudge someone and to provide a fair, open system of review that includes basic due process protections. Loss of RSL status for a mere investigation runs afoul of this basic tenet of our society. A customer, displeased with his or her investment return or the level of client service, might file a complaint that could result in an investigation for failure to supervise by any one of 50 state regulators. Essentially, the supervisor loses the privilege of workplace flexibility for an uncertain and inordinate amount of time. Their lives are disrupted without any adjudication that they failed in their supervisory duties.

### **A Fairer and Practicable Solution: Existing Obligations Under FINRA Rule 3110**

To address these practical challenges and provide basic fairness, we suggest that rather than loss of RSL status, a state investigation for failure to supervise should be considered by a firm's preexisting obligations under Rule 3110 to maintain a reasonably designed supervisory system and to conduct an appropriate risk assessment.

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We urge the SEC to consider the significant impact and unfairness of this new criterion. The alternative SIFMA suggests would still serve investor protection. We appreciate your consideration of our comments. If you have any questions or require further information, please do not hesitate to contact me at (202) 962-7300 or [bcanepa@sifma.org](mailto:bcanepa@sifma.org).

Very truly yours,

*Bernard V. Canepa*

Bernard V. Canepa  
Managing Director &  
Associate General Counsel