



VIA ELECTRONIC MAIL

May 25, 2023

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

Re: File Number SR-FINRA-2023-007: Notice of Filing of a Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) Under FINRA Rule 3110 (Supervision)

Dear Secretary:

On April 14, 2023, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC”) a Notice of Filing of a Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision) (the “Notice”).¹ The Notice proposes to add new Supplementary Material .18 to FINRA Rule 3110 (the “Proposed Rule”), which would adopt a voluntary, three-year remote inspections 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 of their branch offices and locations remotely without an on-site visit to such office or location.

FINRA first proposed the introduction of a remote inspection pilot program in July 2022, with subsequent amendments in December 2022 (the “2022 Proposal”).² The Financial Services Institute (“FSI”) was an active participant in the comment process for FINRA’s initial filing of the 2022 proposal³, the Securities and Exchange Commission’s (“SEC’s”) institution of proceedings to determine whether to approve or disapprove the 2022 Proposal⁴, and the subsequent December 2022 amendment.⁵ FSI’s three comment letters largely expressed support for the 2022 Proposal – applauding FINRA’s efforts to modernize its rules to reflect technological advances in supervision and an evolution to a geographically decentralized work force model.

¹ See Securities and Exchange Act Release No. 34-97398 (April 28, 2023) 88 Fed. Reg. 28620 (May 4, 2023) (Notice of Filing of File No. SR-FINRA-2023-007), available at <https://www.finra.org/sites/default/files/2023-05/NOF-FINRA-2023-007.pdf>.

² See Securities Exchange Act Release No. 34-95452 (Aug. 9, 2022) 87 Fed. Reg. 50144 (Aug. 15, 2022) (Notice of Filing of File No. SR-FINRA-2022-021), available at <https://www.govinfo.gov/content/pkg/FR-2022-08-15/pdf/2022-17428.pdf>.

³ FSI’s September 6, 2022 comment letter in response to FINRA’s initial filing of the 2022 Proposal is posted at <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20138367-308400.pdf>.

⁴ FSI’s December 7, 2022 comment letter in response to the SEC’s institution of proceedings is posted at <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20152465-320322.pdf>.

⁵ FSI’s January 12, 2023 comment letter in response to FINRA’s December 2022 amendments to the 2022 Proposal is posted at <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20154754-322991.pdf>.

The terms of the Proposed Rule are substantially similar to the 2022 Proposal.⁶ FSI strongly believes that the Proposed Rule takes a measured approach, balancing the need for rules that allow for a modernized, reasonably designed supervisory system with FINRA's core investor protection objectives. For this reason, and the reasons set forth in more detail below, FSI supports the Proposed Rule.

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 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.⁷ These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers ("IBD").⁸ 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.⁹

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

We appreciate FINRA's review of its rules with an eye towards modernization and support its proposal to adopt a pilot program that reflects the current work environment and availability of technology to support remote inspections, which are one component of firms' broader supervisory programs. FSI firmly supports FINRA's statement in the Notice that "regulatory models should evolve from the availability and use of effective technology tools" given the "confluence of advances in compliance technology and the shift to hybrid work arrangements."¹⁰

⁶ 88 Fed. Reg. 28620 ("... the terms of the proposed rule change herein are largely similar to File No. SR-FINRA-2022-021 filed in July 2022, then amended in December 2022 . . .").

⁷ Cerulli Associates, Advisor Headcount 2016, on file with author.

⁸ 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.

⁹ Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2020).

¹⁰ 88 Fed. Reg. 28624.

1. FINRA Rule 3110(c) is Ripe for Modernization Given Evolving Business Practices, Advancements in Compliance Technology, and the Benefits of Hybrid Work.

In proposing the pilot program, FINRA explains in the Notice that, since the time Rule 3110(c) was interpreted to require on-site inspections of branch offices and non-branch locations, the broker-dealer industry has changed significantly based on widespread advances in business practices and technology.¹¹ Most firms have moved toward electronic solutions for many functions, including, for instance, recordkeeping, communications (e.g., e-mail, video, online messaging), and platforms for opening and placing trades in customer accounts.¹² FSI agrees with FINRA's assessment in the Notice that, because of the widespread advances in technology and communications in the financial industry, "the challenges in supervising associated persons in outlying offices or locations have been mitigated over the years with the prevalent and effective use of technology."¹³ Further, the increased digitization of firm data and centralization of control functions has allowed firms to actively monitor its associated persons, no matter their location, on a continuous basis, rather than relying on periodic, in-person inspections.¹⁴

As pandemic concerns moderate, many firms have implemented hybrid work models, with employees working both on-site in a conventional office and remotely in a private residence. FSI members, because of their business model, have long operated in such a decentralized structure, with advisors serving clients in the communities where they live across the country, including rural America. While many FSI members, even prior to the pandemic, employed technology as part of their inspection programs, with a considerable amount of pre-work being done prior to arriving at a location on-site, the pandemic prompted firms to optimize and expand on these capabilities by making additional investments in compliance technology.

Since the temporary relief has been in place, many FSI members have used remote inspections (observing the requirements established by FINRA's temporary relief) with some firms now using a combination of remote and in-person inspections as health-related concerns have lessened. FSI members have found success using technology to assist in completing remote inspections, leveraging video conferencing tools, e-mail and document review (i.e., secure website to obtain scanned documents), and using publicly available searches, for example, to review for any undisclosed outside business activities. FSI members (along with many other commenters on FINRA's 2022 Proposal) have not reported any significant departures from pre-pandemic inspection results as a result of using remote inspections.

The confluence of these three factors – a changing business environment, increased investment in compliance technology, and a move towards remote work – indicates that the time is ripe for the Proposed Rule. The flexibility provided by remote and hybrid work arrangements benefit workers, especially primary caregivers who are usually women, and providing these types of work arrangements is important to firms in order to hire and retain underrepresented persons in the financial services profession. FSI further believes that the Proposed Rule would impose appropriate safeguards, requirements, and specific documentation obligations to ensure that investor protection is not compromised, specifically in its requirement that firms undertake a risk-based assessment of each office and location prior to using remote inspections. The required risk-based assessment, coupled with restrictions that limit or restrict the ability of certain higher-risk

¹¹ *Id.* at 28622.

¹² *Id.* at 28623.

¹³ *Id.*

¹⁴ *Id.*

firms and firm offices from participating in remote inspections, will ensure that investors are protected.

2. Risk Assessment and Documentation

The Proposed Rule requires member firms to conduct a “risk assessment of each office or location” which specifically considers seven enumerated factors: (1) the volume and nature of customer complaints; (2) the volume and nature of outside business activities, particularly investment-related; (3) the volume and complexity of products offered; (4) the nature of the customer base, including vulnerable adult investors; (5) whether associated persons are subject to heightened supervision; (6) failures by associated persons to comply with the member’s written supervisory procedures; and (7) any recordkeeping violations.¹⁵ The rule would require firms to “conduct on-site inspections or make more frequent use of unannounced, on-site inspections for high-risk locations or where there are ‘red flags’.”¹⁶

While the 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.

3. FINRA’s Proposal to Collect 2019 Data May Preclude Certain Firms from Participating in the Pilot Program

The Proposed Rule imposes additional obligations on participating member firms to provide data for calendar year 2019 related to: (1) the number of offices and location with an inspection completed; and (2) the number of offices and locations where findings were identified, the number of those findings, and a list of the most significant findings.¹⁷ FSI supports FINRA’s proposal to collect uniform data from member firms on remote inspections, which includes the elements of the risk-based approach that firms implement, the type and frequency of inspections, and the type of office or location inspected. FSI agrees with FINRA’s statement in the Notice that the uniform collection of data would “allow FINRA to assess the benefits and costs of allowing some element of remote inspections of branch office and non-branch office locations, under specified conditions, in the post-pandemic world.”¹⁸

FSI further understands the value of FINRA obtaining information from firms about previous on-site inspections to form a baseline to evaluate remote inspections. However, we note that FINRA Rule 3110(c)(2) provides that “an inspection and review by a member pursuant to

¹⁵ See Proposed Rule 3110.18(b)(2).

¹⁶ *Id.*

¹⁷ See Proposed Rule 34110.18(h)(3).

¹⁸ 88 Fed. Reg. at 28635.

paragraph (c)(1) must be reduced to a written report and kept on file by the member for a minimum of three years . . .”¹⁹ The Proposed Rule requires, as a prerequisite for firms to participate in the pilot program, the provision of 2019 data that would likely be found in inspection reports created pursuant to FINRA Rule 3110(c)(2). Because these inspection reports are only required to be maintained for a period of three years, some member firms may no longer maintain inspection reports for certain offices and/or locations from 2019. There is a concern that the inability of a firm to provide such information would exclude the firm from being able to participate in the pilot program.

FSI believes that firms should be allowed to participate in the pilot even if they cannot provide all of the requested information due to the limited term of FINRA’s recordkeeping requirement in FINRA Rule 3110(c)(2). We recommend that the information sharing requirement be revised to require providing the information “if available in the firm’s records” and requiring firms to make a “best efforts” attempt to collect the requested information.

Conclusion

FSI is committed to constructive engagement in the regulatory process and welcomes the opportunity to work with the SEC on this and other regulatory efforts. Thank you for considering FSI’s comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,



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

¹⁹ *Id.*