



August 29, 2023

Submitted by SEC Webform (<http://www.sec.gov/rules/sro.shtml>)

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

RE: File No. SR-FINRA-2023-007: Notice of Filing of Amendment No. 1 and Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 1, To Adopt Supplementary Material .18 (Remote Inspections Pilot Program) Under FINRA Rule 3110 (Supervision)

Dear Ms. Haywood:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),¹ I am writing in response to U.S. Securities and Exchange Commission (“SEC” or the “Commission”) Release No. 34-98046, *Notice of Filing of Amendment No. 1 and Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 1, To Adopt Supplementary Material .18 (Remote Inspections Pilot Program) Under FINRA Rule 3110 (Supervision)*, 88 Fed. Reg. 53569 (Aug. 8, 2023) (the “Revised Proposal”).² The Revised Proposal would modify certain aspects of SEC Release No. 34-97398, *Notice of Filing of a Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision)* (the “Pilot Proposal”)³ previously submitted to the SEC by the Financial Industry Regulatory Authority, Inc. (“FINRA”).

¹ 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.

² FINRA’s submission of the Revised Proposal is available at <https://www.finra.org/sites/default/files/2023-08/SR-FINRA-2023-007-Amendment-1.pdf>.

³ The Pilot Proposal is available at <https://www.sec.gov/rules/sro/finra/2023/34-97398.pdf>.

This comment letter responds to the Revised Proposal and supplements NASAA’s May 25, 2023, comment letter on the Pilot Proposal.⁴

NASAA’s May 25 comment letter recommended several revisions to the Pilot Proposal. Specifically, our comment letter recommended that the Pilot Proposal be more prescriptive regarding broker-dealer risk assessment requirements, standards for written supervisory procedures and supervisory capabilities, and regulatory disclosure requirements.⁵ We appreciate that FINRA incorporated some of these recommendations into the Revised Proposal.⁶ However, we believe the Revised Proposal still does not go far enough to protect investors. Accordingly, we recommend that FINRA or the SEC implement the following revisions to the Revised Proposal before it can be considered appropriate for approval.

I. FINRA Should Define “Significant Findings” More Precisely.

We appreciate that FINRA changed the proposed regulatory disclosure standard in Rule 3110.18(h) from “most significant findings” to “significant findings.”⁷ However, for the reasons expressed in our May 25 comment letter, NASAA continues to recommend that this regulatory disclosure standard be “all findings”⁸ in order to remove the possibility that the varying subjective judgments of firms as to what is “significant” might skew the data used to evaluate the effectiveness of the pilot program. However, if FINRA and the SEC decide to proceed with the “significant findings” approach, this standard should at least be defined with more precision so that it can be the most useful to FINRA and the brokerage industry.

The “significant findings” disclosure standard currently set forth in Rule 3110.18(h) is likely to prove problematic for FINRA and broker-dealers more broadly because it lacks specificity. Broker-dealers participating in the pilot program ought to have a common understanding of what findings are significant – and therefore will require specific enumeration to FINRA in a Rule 3110.18(h) report. But the necessary specificity is still lacking from the Revised Proposal.

The Pilot Proposal stated that a finding would be considered “significant” if the finding was something that should cause a firm to take action. As examples, the Pilot Proposal cited

⁴ See Letter from Andrew Hartnett, NASAA President and Deputy Commissioner, Iowa Insurance Division, to Sherry R. Haywood, Assistant Secretary, *Re: File No. SR-FINRA-2023-007* (May 25, 2023), <https://www.sec.gov/comments/sr-finra-2023-007/srfinra2023007-194939-387162.pdf> (the “NASAA May 25 Comment Letter”). NASAA also submitted three comment letters in response to a prior related FINRA proposal (*see id.* n. 4).

⁵ *See id.*

⁶ *See Revised Proposal, supra* note 2, at 5-6 (stating FINRA revised proposed Rule 3110.18(b)(2) in light of NASAA’s comment letter).

⁷ *See id.* at 6.

⁸ *See id.* at 7; NASAA May 25 Comment Letter, *supra* note 4, at 8.

unapproved communication mediums, customer complaints, or undisclosed outside business activities or private securities transactions.⁹ The Revised Proposal restates these standards.¹⁰

We believe FINRA must set a clearer test for when a finding is “significant.” If two broker-dealers have identical findings in their internal remote inspections, they ought to reach identical conclusions about whether those findings are significant (and therefore must be reported to FINRA). Without clear guidance, different broker-dealers will inevitably reach different conclusions, leading one broker-dealer to disclose an event as significant while another broker-dealer does not, treating the event as a mere “finding” to be tallied. Such disparate outcomes would be counterproductive for FINRA (and, ultimately, the SEC) because it would give FINRA a misimpression of the overall effectiveness of the pilot program and the extent to which compliance problems exist across the brokerage industry. Imprecision is also bad for the broker-dealer industry more generally, as this incentivizes nondisclosure – a proverbial ‘race to the bottom’ – among pilot program participants. NASAA thus disagrees with FINRA that broker-dealers “should have the agency to assess what constitutes their significant findings.”¹¹ This is especially true for a pilot program, the purported purpose of which is to gather data to inform future rulemaking. The SEC should instead insist that FINRA craft a more precise standard (or set of standards) for when a “finding” is “significant” for purposes of Rule 3110.18(h).¹²

II. Broker-Dealers Should be Required to Collect and Provide 2019 Data Or at Least to Document Why Their Inability to Provide Complete Data was Reasonable.

In response to two comment letters from the brokerage industry, FINRA amended proposed Rule 3110.18(h)(3) in the Revised Proposal to permit broker-dealers to participate in the pilot program even if they have not retained their calendar year 2019 compliance data as would otherwise be required. To rely on this exception, broker-dealers would only need to exercise their best efforts in good faith to compile this data.¹³ The effect of this exception would be to permit broker-dealers to participate in the pilot program if, for example, they have automated internal document destruction policies that have since purged some or all of their 2019 compliance records.

NASAA does not support this change as proposed. First, while it is certainly possible that some broker-dealers might have purged some or all of their 2019 compliance data and therefore need this exception in order to participate in the pilot program, we do not believe this is likely.

⁹ See Pilot Proposal, *supra* note 3, at 45 n.92.

¹⁰ See Revised Proposal, *supra* note 2, at 6.

¹¹ See *id.*

¹² For example, FINRA set very clear reporting standards in Rule 4530, *Reporting Requirements*, <https://www.finra.org/rules-guidance/rulebooks/finra-rules/4530>. Although FINRA is presumably anticipating a very different scope of “significant” disclosures under the pilot program, we see no reason that FINRA cannot provide similarly clear guidance for purpose of the pilot program.

¹³ See Revised Proposal, *supra* note 2, at 7.

Sherry R. Haywood

August 29, 2023

Page 4 of 4

Broker-dealers routinely retain data and information for far longer than is required by the minimum SEC and FINRA document retention standards (whether on live information systems or through backup data files). Further, because most firms retain this data – and indeed should have been aware of the need to preserve such data as the baseline data requirements of the Pilot Proposal have been public knowledge – we believe that enough firms will have such data in order to allow FINRA to have a necessary mass of data to evaluate the effectiveness of the pilot program without allowing firms to participate who cannot produce baseline data. Second, given that FINRA’s underlying purpose in creating the pilot program is to assess the potential regulatory and compliance impacts of permitting remote inspections on an industrywide basis, the pilot program should have uniform standards for participation. Permitting broker-dealers to participate without a common set of baseline compliance data would undermine the very purpose of the program (a bit like running a science experiment without a consistent control). Further, permitting firms to avoid providing necessary data before the pilot program has even begun materially undermines the goal of evidence-based rulemaking.

Nevertheless, if FINRA and the SEC do permit this ill-advised exception, the Revised Proposal should at least be adjusted to require that any firm seeking to avail itself of this exception must document its attempts to recover all of its 2019 compliance data. Proposed Rule 3110.18(h)(3) thus should include language requiring that firms document the precise steps in support of their “best efforts in good faith.” Adding this requirement would help protect the integrity of the pilot program against firms that are slipshod in their document retention (or that are actively seeking to evade the pilot program’s requirements).

III. Conclusion.

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