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Page 1 of * 329		SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4		File No. * SR 2023 - * 007 Amendment No. (req. for Amendments *)	
Filing by Financial Industry Regulatory Authority Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934					
Initial * <input checked="" type="checkbox"/>		Amendment * <input type="checkbox"/>		Withdrawal <input type="checkbox"/>	
Section 19(b)(2) * <input checked="" type="checkbox"/>		Section 19(b)(3)(A) * <input type="checkbox"/>		Section 19(b)(3)(B) * <input type="checkbox"/>	
Pilot <input type="checkbox"/>		Extension of Time Period for Commission Action * <input type="checkbox"/>		Date Expires * <input type="text"/>	
		Rule			
		<input type="checkbox"/> 19b-4(f)(1)		<input type="checkbox"/> 19b-4(f)(4)	
		<input type="checkbox"/> 19b-4(f)(2)		<input type="checkbox"/> 19b-4(f)(5)	
		<input type="checkbox"/> 19b-4(f)(3)		<input type="checkbox"/> 19b-4(f)(6)	
Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 Section 806(e)(1) * <input type="checkbox"/>			Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 Section 3C(b)(2) * <input type="checkbox"/>		
Exhibit 2 Sent As Paper Document <input type="checkbox"/>			Exhibit 3 Sent As Paper Document <input type="checkbox"/>		
Description Provide a brief description of the action (limit 250 characters, required when Initial is checked *). <div>Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision)</div>					
Contact Information Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action. First Name * Sarah Last Name * Kwak Title * Associate General Counsel E-mail * sarah.kwak@finra.org Telephone * (202) 728-8471 Fax					
Signature Pursuant to the requirements of the Securities Exchange of 1934, Financial Industry Regulatory Authority has duty caused this filing to be signed on its behalf by the undersigned thereunto duty authorized. Date 04/14/2023 (Title *) By Kosha Dalal Vice President and Associate General Counsel (Name *) <div>NOTE: Clicking the signature block at right will initiate digitally signing the form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.</div> <div>Kosha Dalal Digitally signed by Kosha Dalal Date: 2023.04.14 16:59:40 -04'00'</div>					

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information *

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A - Notice of Proposed Rule Change, Security-Based Swap Submission, or Advanced Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2- Notices, Written Comments, Transcripts, Other Communications

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FINRA-2023-007 Exhibit 2b.pdf		
FINRA-2023-007 Exhibit 2c.pdf		

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

☐ Exhibit Sent As Paper Document

Exhibit 3 - Form, Report, or Questionnaire

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

☐ Exhibit Sent As Paper Document

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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FINRA-2023-007 Exhibit 5.docx		

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”),¹ the Financial Industry Regulatory Authority, Inc. (“FINRA”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend FINRA Rule 3110 (Supervision) to adopt a voluntary, three-year remote inspections pilot program to allow member firms to elect to fulfill their obligation under paragraph (1) to Rule 3110(c) (Internal Inspections) by conducting inspections of some or all branch offices and locations remotely without an on-site visit to such office or location, subject to specified terms. As detailed below, the key terms would include, among others: (1) a requirement for a firm to conduct and document a risk assessment for inspecting an office or location remotely and providing a non-exhaustive list of factors to consider for this risk assessment; (2) criteria that would make a member firm ineligible to participate in the program; (3) conditions a member firm must satisfy before becoming a pilot program participant relating to the firm’s recordkeeping system, and surveillance and technology tools; (4) criteria that would make ineligible for remote inspection certain member firm offices or locations; (5) conditions a member firm’s office or location must satisfy to be able to undergo a remote inspection relating to electronic communications, correspondence, and books and records; (6) a requirement that a participating firm provide FINRA specified data and information on a quarterly basis; and (7) authorization for FINRA to determine in the public interest that a firm is no longer eligible to participate in the proposed program.

¹ 15 U.S.C. 78s(b)(1).

The proposed Remote Inspections Pilot Program would not change the current requirements under Rule 3110(c). Instead, the proposed program would provide firms the flexibility to satisfy their Rule 3110(c)(1) inspection obligation with or without an on-site visit to the office or location, subject to the proposed terms described herein. FINRA believes that proposed Rule 3110.18, on balance, preserves investor protection objectives through the proposed safeguards while also providing FINRA the opportunity to gauge the effectiveness of remote inspections as part of a modernized, reasonably designed supervisory system that reflects the current work environment and availability of technologies that did not exist when the on-site inspection originally was conceived.

Subject to further clarifications to proposed Rule 3110.18 as described below, the terms of the proposed rule change herein are largely similar to File No. SR-FINRA-2022-021 filed in July 2022,² then amended in December 2022³ (together, the “2022 Remote Inspections Pilot Program Rule Filing”). FINRA withdrew File No. SR-FINRA-2022-021 on April 11, 2023 to consider whether more safeguards and clarifications to the filing would be appropriate in response to concerns raised by commenters.⁴ This proposed rule change is organized in five sections: (1) the background, which provides a historical overview of Rule 3110(c), and discusses the environmental changes that have occurred over the years relating to technology and the workplace; (2) FINRA’s observations of

² See Securities Exchange Act Release No. 95452 (August 9, 2022), 87 FR 50144 (August 15, 2022) (Notice of Filing of File No. SR-FINRA-2022-021) (“Initial Rule Filing”); see also Exhibit 2a.

³ See Securities Exchange Act Release No. 96520 (December 16, 2022), 87 FR 78737 (December 22, 2022) (Notice of Partial Amendment No. 1 to File No. SR-FINRA-2022-021) (“Amended Rule Filing”); see also Exhibit 2b.

⁴ See Exhibit 2d.

evolving inspection practices; (3) the emergence of remote inspections as a new approach to evaluation under Rule 3110(c)(1); (4) a description of the terms of the proposed rule change; and (5) an overview of FINRA's monitoring and compliance with proposed Rule 3110.18.

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

I. Background

A. Overview

The responsibility of firms to supervise their associated persons is a critical component of broker-dealer regulation.⁵ Member firms must supervise all of their

⁵ See generally SEC Division of Market Regulation, Staff Legal Bulletin No. 17: Remote Office Supervision (March 19, 2004) ("SLB 17") (SEC guidance on remote office supervision), <https://www.sec.gov/interps/legal/mrslb17.htm>; and Regulatory Notice 11-54 (November 2011) ("Notice 11-54") (joint SEC and FINRA guidance on effective policies and procedures for broker-dealer branch inspections).

associated persons, regardless of their location, compensation or employment arrangement, or registration status.⁶ Rule 3110 requires a member, regardless of size or type, to have a supervisory system for the activities of its associated persons that is reasonably designed to achieve compliance with the applicable securities laws and regulations and FINRA rules, and sets forth the minimum requirements for such supervisory system.⁷ The internal inspection obligation under Rule 3110(c) is one component of such system.

Before the adoption of Rule 3110(c) in its current form as described below, FINRA's (then NASD's) Rules of Fair Practice⁸ required a member firm to review the

⁶ This obligation is consonant with Sections 15(b)(4)(E) and 15(b)(6)(A) of the Exchange Act. Section 15(b)(4)(E) provides that the:

Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer if it finds . . . that such broker or dealer . . . or any person associated with such broker or dealer . . . has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any person of any provision of the Securities Act of 1933, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, [the Securities Exchange Act of 1934], the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, or has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. 15 U.S.C. 78o(b)(4)(E).

Section 15(b)(6)(A)(i) parallels Section 15(b)(4)(E) and provides for the imposition of sanctions against persons associated with a broker or dealer that violates those statutes, rules and regulations enumerated in Section 15(b)(4)(E) and other specified subparagraphs under Section 15(b)(4). 15 U.S.C. 78o(b)(6)(A).

⁷ See Rule 3110(a).

⁸ Then NASD adopted its Rules of Fair Practice when it was founded in 1939 under provisions of the 1938 Maloney Act amendments to the Exchange Act.

activities of each office including the periodic examination of customer accounts to detect and prevent irregularities and abuses and at least an annual inspection of each OSJ.⁹

Subsequently, FINRA expanded the review requirement to include not only the activities of each office, but also the businesses in which a member firm engages.¹⁰

The expanded review requirement included, among other things, an inspection of branch offices in accordance with a schedule as set forth in the member's supervisory procedures.¹¹ This expansion was intended to address concerns about the adequacy of ongoing supervision and regular examination of associated persons engaged in the offer and sale of securities to the public at locations away from a member firm's office.¹² FINRA guidance during this period of supervisory change focused on the need for the effective supervision of the securities-related activities of "off-site representatives," and advised firms of the importance of not only reviewing their supervisory systems and procedures to ensure that they were current and adequate, but also conducting inspections to determine whether these systems and procedures were being followed.¹³ Further, the guidance advised firms that an inspection should include, among other things, a "review

⁹ See Notice to Members 87-41 (June 1987) ("Notice 87-41") (setting forth the proposed rule text changes to Article III, Section 27 of the NASD Rules of Fair Practice for the review and annual inspection requirement, among other provisions).

¹⁰ See Notice to Members 88-84 (November 1988) ("Notice 88-84").

¹¹ See Notice 88-84. By 2004, the requirement to inspect a branch office in accordance with a regular schedule as set forth in the member's supervisory procedures was replaced by mandatory inspection cycles as set forth under Rule 3110(c)(1). See Notice to Members 04-71 (October 2004).

¹² See Notice 88-84.

¹³ See Notice to Members 99-45 (June 1999) ("Notice 99-45").

of any on-site customer account documentation and other books and records, meetings with individual registered representatives to discuss the products they are selling and their sales methods, and an examination of correspondence and sales literature.”¹⁴

The guidance about the effective supervision of “off-site representatives” and what an inspection entailed was pragmatic at a time when business activities were conducted primarily using paper documents¹⁵ that were created and stored locally at an office or location; registered persons were interacting with their customers largely through in-person meetings, paper-based correspondence transmitted through the postal service, and landline telephone calls; and supervisory personnel were conducting supervision through manual reviews of paper files (e.g., exception reports bearing a supervisor’s handwritten comments and initials or signature). In that environment, the best practice to determine whether the firm’s supervisory system and procedures were being followed was through having firm compliance personnel visit the office or location. This practice has remained the prevailing means to satisfy the inspection obligation under Rule 3110(c)(1).

Currently, Rule 3110(c) sets forth three main requirements for inspections. First, an inspection of an office or location must occur on a designated frequency. The periodicity of the required inspection varies depending on the classification of the location or the nature of the activities that take place: OSJs and supervisory branch

¹⁴ See Notice to Members 98-38 (May 1998) (“Notice 98-38”) and Notice 99-45; see also Notice to Members 86-65 (September 1986) (“Notice 86-65”).

¹⁵ Paper-based documents included, for example, customer account opening documents; correspondence with customers; marketing materials; communications from registered persons to the firm; order tickets; checks received and forwarded; and fund transmittal records.

offices must be inspected at least annually;¹⁶ non-supervisory branch offices, at least every three years;¹⁷ and non-branch locations, on a periodic schedule, presumed to be at least every three years.¹⁸ Second, a member must retain a written record of the date upon which each review and inspection occurred, reduce a location's inspection to a written report and keep each inspection report on file either for a minimum of three years or, if the location's inspection schedule is longer than three years, until the next inspection report has been written.¹⁹ If applicable to the location being inspected, the inspection report must include the testing and verification of the member's policies and procedures, including supervisory policies and procedures, in specified areas.²⁰ Third, to prevent compromising the effectiveness of inspections due to conflicts of interest, the rule requires a member to ensure that the person conducting the inspection is not an associated person assigned to the location or is not directly or indirectly supervised by, or otherwise

¹⁶ See Rule 3110(c)(1)(A).

¹⁷ See Rule 3110(c)(1)(B).

¹⁸ See Rules 3110(c)(1)(C) and 3110.13 (General Presumption of Three-Year Limit for Periodic Inspection Schedules).

¹⁹ See Rule 3110(c)(2).

²⁰ See Rule 3110(c)(2)(A) (providing that the inspection report must include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures for: (1) safeguarding of customer funds and securities; (2) maintaining books and records; (3) supervision of supervisory personnel; (4) transmittals of funds from customers to third party accounts, from customer accounts to outside entities, from customer accounts to locations other than a customer's primary residence, and between customers and registered representatives, including the hand delivery of checks; and (5) changes of customer account information, including address and investment objectives changes, and validation of such changes).

reporting to, an associated person assigned to that location.²¹ All branch offices and non-branch locations are subject to Rule 3110(c).

Further, Rule 3110.12 (Standards for Reasonable Review) sets out factors that constitute a reasonable review. This provision emphasizes establishing reasonable supervisory procedures and conducting reviews of locations, taking into consideration, among other things, the member's size, organizational structure, scope of business activities, number and location of the member's offices, the nature and complexity of the products and services offered by the member, the volume of business done, the number of associated persons assigned to a location, the disciplinary history of registered representatives or associated persons, and any indicators of irregularities or misconduct (i.e., "red flags").²² The provision further states that the procedures established and

²¹ Rule 3110(c)(3) provides a limited exception from this requirement if a firm determines compliance is not possible either because of the firm's size or its business model. Rule 3110.14 (Exception to Persons Prohibited from Conducting Inspections) reflects FINRA's expectation that a firm generally will rely on the exception in instances where the firm has only one office or has a business model where small or single-person offices report directly to an OSJ manager who is also considered the offices' branch office manager. However, these situations are non-exclusive, and a firm may still rely on the exception in other instances where it cannot comply because of its size or business model, provided the firm complies with the documentation requirements under the rule.

²² Such red flags may include: customer complaints; a large number of elderly customers; a concentration in highly illiquid or risky investments; an unexplained increase or change in the types of investments or trading concentration that a representative is recommending or trading; an unexpected improvement in a representative's production, lifestyle, or wealth; questionable or frequent transfers of cash or securities between customer or third party accounts, or to or from the representative; a representative that serves as a power of attorney, trustee or in a similar capacity for a customer or has discretionary control over a customer's account(s); a representative with disciplinary records; customer investments in one or a few securities or class of securities that is inconsistent with firm policies related to such investments; churning; trading that is inconsistent with customer objectives; numerous trade corrections, extensions, liquidations; or significant

reviews conducted must provide that the quality of supervision at remote (i.e., geographically dispersed) locations is sufficient to ensure compliance with applicable securities laws and regulations and with FINRA rules, and that members must be especially diligent with respect to a non-branch location where a registered representative engages in securities activities. This provision incorporates guidance FINRA has previously issued about supervising associated persons working in geographically dispersed offices.²³

In 2004, the SEC staff similarly provided guidance to broker-dealers on supervision principles.²⁴ At that time, the SEC staff noted that small, geographically scattered offices presented supervisory challenges when they were not subject to on-site supervision. The SEC staff observed that an office's geographic distance from supervisory personnel could make it easier for registered persons and other employees to carry out and conceal violative conduct. This general observation was derived from SEC enforcement cases finding that firms had inadequately supervised their associated persons working in small, geographically distant offices due to the failure of their supervisory mechanisms to detect and prevent misconduct. Citing technology available at the time, the guidance emphasized that an effective supervisory system for geographically dispersed offices uses a combination of on-site and off-site monitoring; it specifically said that "[c]entralized technology to monitor the trading and handling of funds in remote

switching activity of mutual funds or variable products held for short time periods. See SLB 17, supra note 5; see also Notices 98-38 and 99-45.

²³ See, e.g., Notices 98-38 and 99-45.

²⁴ See SLB 17, supra note 5.

office accounts, as well as the use of personal computers, helps detect misappropriation of customer funds, selling away, and unauthorized trading, among other things[.]”²⁵ The guidance supported both routine or “for cause” on-site inspections, and encouraged unannounced inspections either on a random basis or where there are red flags about unusual activity at those offices. Further, SEC staff and FINRA issued joint guidance that included a FINRA interpretation of Rule 3110(c)(1) requiring member firms to conduct on-site inspections of branch offices and unregistered offices (i.e., non-branch locations) and stating that the inspection process is an element of a firm’s compliance and reasonable supervision of its offices and locations, and personnel, and a component of a firm’s risk management program.²⁶ In the joint guidance, the SEC and FINRA also articulated that the “inspection provides the firm with the opportunity to validate its surveillance results from branch offices and to gather on-site intelligence that supplements the ongoing management and surveillance of the branch from a business and risk management standpoint.”²⁷ Since the time these in-person guidelines were expressed, workplace models have changed significantly and developments in technology have enhanced firms’ overall and ongoing supervision and monitoring of the activities

²⁵ See SLB 17, supra note 5.

²⁶ See Notice 11-54 (stating, in part, a “broker-dealer must conduct on-site inspections of each of its office locations; [OSJs] and non-OSJ branches that supervise non-branch locations at least annually, all non-supervising branch offices at least every three years; and non-branch offices periodically.”). See also SLB 17 (stating, in part, that broker-dealers that conduct business through geographically dispersed offices have not adequately discharged their supervisory obligations where there are no on-site routine or “for cause” inspections of those offices), <https://www.sec.gov/interp/legalslrb17.htm>.

²⁷ See Notice 11-54.

occurring at branch offices and non-branch locations. In response to these developments, member firms have questioned the historical expectation that firms satisfy the inspection component of Rule 3110(c) in a physical, on-site manner.

B. Environmental Changes Support Revision of In-Person Supervisory Conventions Relating to Rule 3110(c)(1)

Over the years, widespread advancements in technology and communications in the financial industry have significantly changed the way in which members and their associated persons conduct their business and communicate, including the practices that formed the original bases for the on-site inspection. For example, making and preserving records electronically have increasingly become the norm and the preferred recordkeeping medium rather than paper (e.g., cloud based storage); communications between and among members, their associated persons and customers commonly take place through email, video or online meeting programs (e.g., WebEx, Zoom) that can be monitored electronically by firms;²⁸ processes for opening customer accounts and placing trades are moving to online platforms; and customer funds and securities are frequently and increasingly transmitted electronically rather than in physical form (e.g., Venmo,

²⁸ Many customers now expect their primary mode of interaction with their firm to be digital. In a study to learn about investors who, during year 2020, entered into the markets using taxable, non-retirement investment accounts, FINRA found that nearly half (48%) of “new investors,” investors who opened a non-retirement investment account during 2020, indicated that they accessed their account primarily through a mobile app, and three-quarters (75%) of “holdover account owners,” investors who maintained a taxable investment account opened before year 2020, indicated they accessed their account primarily through a website. See generally FINRA Investor Education Foundation & NORC, Consumer Insights: Money & Investing, Investing 2020: New Accounts and the People Who Opened Them at 11 (February 2021), https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf.

Zelle). Relatedly, the challenges in supervising associated persons who work in outlying offices or locations (i.e., “off-site representative”) have been mitigated over the years with the prevalent and effective use of technology. For example, supervisory reviews for outside business activities of registered persons are often conducted through general internet searches, including social media and online public records, and by reviewing electronic communications and customer fund transfers. Similarly, reviews of correspondence, customer funds and securities, and order flows are accomplished primarily through the use of electronic tracking programs or applications.

In addition, the progressive digitization of firm data and the centralization of control functions have converged, with significant advantages for a firm’s supervision of its business, including monitoring of an associated person’s activities and conducting inspections. Today, many firms capture the lifecycle of an associated person’s activities with a firm, as well as a customer’s interactions with the firm, in digital audit trails. Such activities include, for example, information about associated persons and customers obtained at the account opening process; communications between associated persons and customers or among associated persons; order and trade activity; and money and security movements in customer accounts. As a result, a firm can monitor the activities of its associated persons and customers continuously, on a real-time or near-real time basis, and react promptly to actual or potential exceptions to routine behaviors, rather than depend on a “point-in-time” office inspection visit on a prescribed schedule.

Further, increased digitization has centralized elements of firm compliance and supervisory functions, and these centralized functions have become the front line in supervision and surveillance. Rather than having a firm’s compliance personnel walk

around an office or location during an inspection to identify potential problems or to gather on-site intelligence—an approach that relies on chance encounters such as overhearing an associated person making a sales pitch to a customer for a product a firm is not approved to sell or observing an associated person cutting and pasting a customer signature onto a form—digitization now allows a firm to readily “walk around the data,” reducing the member’s dependence on on-site intelligence because most of activities occurring at an office or location are electronically captured. The technology-driven environment has provided firms the opportunity to develop a more holistic view of a firm’s risk management programs, fostering a more efficient and timely response to areas of concern. For example, centralized control functions strengthen supervision by enabling a firm to implement more frequent or ongoing, repeatable, consistent, and highly scalable approaches to analyzing the activities of associated persons across dispersed offices and locations, creating a level of process discipline not previously achievable in the past. These centralized control functions allow a firm to identify potential areas of concern, and implement targeted solutions or preventative measures in a more timely manner. For example, a fraud specialist team may identify a new fraud scenario and then promptly implement a new surveillance pattern to identify red flags for this behavior throughout the firm. A firm may also use in-house or vendor-created technologies to regularly adjust and “right size” its surveillance alerts and patterns. For example, a firm may quickly adjust its email review lexicons to surveil communications relating to any topic or term.

FINRA notes that firms are turning to new and innovative regulatory tools such as artificial intelligence, natural language processing, and robotics process automation,

among others, to strengthen their compliance programs.²⁹ Over the last few years, firms have questioned the benefits and practicalities of the need to conduct an inspection in an on-site manner for each office and location, particularly in light of these significant technological advances that have not only changed the way in which firms conduct business and communicate, but also enhanced the effectiveness and efficiencies of a firm's overall and ongoing supervision and monitoring of the activities occurring at their offices and locations.³⁰

C. Impact of the Pandemic on Workplace Arrangements, and Diversity, Equity and Inclusion

The COVID-19 pandemic, identified in early 2020,³¹ has had a profound and lasting impact on workplace arrangements, and brought focus to the integrity of firms' supervisory systems in a more dispersed work environment. The pandemic accelerated the use of a wide variety of compliance and workplace technology as many government

²⁹ See generally FINRA White Paper, Technology Based Innovations for Regulatory Compliance ("RegTech") in the Securities Industry (September 2018), https://www.finra.org/sites/default/files/2018_RegTech_Report.pdf.

³⁰ Some firms have indicated, for example, that technology has enhanced real time monitoring of their associated persons by providing the ability for firm compliance personnel to join, on an ad hoc basis, digital or virtual meetings occurring between the firm's associated persons and customers. Firms have also indicated that technology has allowed them to impose various restrictions or limitations on associated persons, such as the ability to print firm records from remote locations using a firm-issued laptop, and only accepting electronic payments from customers.

³¹ See Centers for Disease Control and Prevention ("CDC"), International Classification of Diseases, Tenth Revision, Clinical Modification (ICD-10-CM) (Effective March 18, 2020), <https://www.cdc.gov/nchs/data/icd/Announcement-New-ICD-code-for-coronavirus-3-18-2020.pdf>. See also WHO Director-General's Opening Remarks at the Media Briefing on COVID-19 (March 11, 2020), <https://www.who.int/director-general/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020>.

and private employers, including member firms, were driven to adopt a broad remote work environment by quickly moving their employees out of their usual office setting to an alternative worksite such as a private residence. Insights obtained from member firms and other industry representatives through various pandemic-related initiatives and other industry outreach have led FINRA to carefully consider whether some processes and rules, including the manner in which a firm may satisfy its Rule 3110(c)(1) obligations, should be modernized.³² Technological improvements and developments in regulatory compliance have provided more tools than before to create more effective and efficient compliance programs. To that end, FINRA believes that regulatory models should evolve to benefit from the availability and use of effective technology tools. The SEC's recent Strategic Plan similarly recognized that "[t]echnology and business models are always changing, and it is important for [the SEC] to evolve in kind[.]" and expressed the

³² See generally FINRA's Key Topic: COVID-19/Coronavirus (referencing, among other things, Frequency Asked Questions, temporary amendments to FINRA rules, and Regulatory Notices such as Regulatory Notices 20-08 (March 2020) ("Notice 20-08"), regarding pandemic-related business continuity planning, guidance and regulatory relief to member firms from some requirements, including the temporary suspension of the requirement to maintain updated information on Form U4 (Uniform Application for Securities Industry Registration or Transfer) and submit Form BR (Uniform Branch Office Registration Form) for temporary locations; 20-16 (May 2020) ("Notice 20-16"), describing practices implemented by firms to transition to, and supervise in, remote work environment during the COVID-19 pandemic; 20-42 (December 2020) ("Notice 20-42"), seeking comment on lessons from the pandemic; and 21-44 (December 2021), regarding business continuity planning and lessons from the pandemic, <https://www.finra.org/rules-guidance/key-topics/covid-19>). See also SEC Press Release 2022-112 (June 22, 2022) for the Spring 2022 Regulatory Agenda (quoting SEC Chair Gary Gensler: "When I think about the SEC's agenda, I'm driven by two public policy goals: continuing to drive efficiency in our capital markets and modernizing our rules for today's economy and technologies."), https://www.sec.gov/news/press-release/2022-112?utm_medium=email&utm_source=govdelivery.

overall need to “[u]pdate existing SEC rules and approaches to reflect evolving technologies, business models, and capital markets.”³³ With the confluence of advances in compliance technology and the shift to hybrid work environments, FINRA believes that the optimal use of on-site inspections deserves further consideration as part of the overall effort to modernize FINRA rules to reflect evolving technologies and business models.³⁴ As such, FINRA believes it is appropriate now to assess possible longer-term rule changes and is, therefore, proposing a voluntary, three-year remote inspections pilot program. This program would provide FINRA with specific, structured data from pilot program participants to evaluate impacts—positive and negative—on inspection findings and to systematically assess the overall impact on firms’ supervisory systems, which has not been feasible with information drawn from the pandemic-related office shutdowns. Moreover, the proposed pilot program would maintain effective supervision by firms through the ongoing supervisory obligations under Rule 3110, and the proposed limitations on the firms and locations that would be eligible to participate in the proposed

³³ See SEC, Strategic Plan for fiscal years 2022 to 2026 (November 23, 2022), https://www.sec.gov/files/sec_strategic_plan_fy22-fy26.pdf.

³⁴ FINRA notes one state regulator has issued a policy statement, acknowledging that “more businesses have adapted practices, hired employees, and instituted other changes to their compliance initiatives which have allowed them to adapt to working from a remote setting.” As a result, the state securities commissioner concluded that a “full and thorough Branch Inspection conducted remotely may allow broker-dealers similar opportunity to monitor practices and ensure regulatory compliance when compared with in-person Branch Inspections.” Through this policy statement, a broker-dealer registered in the state may satisfy that state’s branch office examination requirements through remote inspections by using mediums such as video conference and digital file sharing. See Indiana Secretary of State Securities Division, Statement of Policy Regarding Broker-Dealer Branch Office Examinations in 2023 (January 13, 2023), <https://securities.sos.in.gov/sop-bd-branch-exams-2023>

pilot program. FINRA emphasizes that the proposed pilot program is not intended to signal the abandonment of on-site inspections, but to assess the effectiveness and efficiency of additional approaches, subject to specified controls, for firms to meet their inspection obligations under Rule 3110(c)(1) while still preserving the investor protection objectives of the rule.

Firms have also conveyed that the flexibility of hybrid work has made a positive impact in attracting more diverse talent and retaining existing talent. These views are consistent with those expressed by several commenters in response to the Initial Rule Filing.³⁵ For example, several commenters to the Initial Rule Filing noted the positive impact that proposal was expected to have on workplace flexibility and hiring efforts that would enhance talent recruitment and retention in the financial industry, particularly with respect to diversity and inclusion initiatives.³⁶ In general, the U.S. workforce has increasingly demanded greater workplace flexibility and the securities industry is subject to the same national pressures as it aims to recruit and retain diverse, talented and qualified employees, especially supervisors essential to a reasonably designed

³⁵ See Exhibit 2c.

³⁶ See Exhibit 2c.

supervisory program.³⁷ Notably, the SEC has also indicated that it needed to “harness the benefits of telework as highlighted during the pandemic[.]”³⁸

II. FINRA’s Observations of Evolving Inspection Practices

Over the last decade, FINRA has observed that the widespread advances in technology in the financial industry, including the progressive digitization of data and the centralization of control functions, have given firms the greater ability to continuously monitor for, identify and investigate atypical behaviors or patterns. With this evolution, the importance of on-site inspections as a primary means to identify non-compliant conduct at all offices and locations has seemingly diminished. Inspection practices that previously depended on an on-site presence at an office or location included, for example, reviewing paper-based books and records (e.g., logs or blotters reflecting transmittals of funds and securities, and paperwork related to new customer accounts); testing the implementation of controls at the office or location relating to the security of checks and stock certificates, the security of an office or location itself (e.g., secured file cabinets containing paper-based books and records); reviewing how supervisors perform their functions such as ensuring that an associated person’s uniform form filings were current and accurate; and looking for physical signs of an associated person’s outside

³⁷ See, e.g., McKinsey & Company, Americans are embracing flexible work—and they want more of it (June 23, 2022) (highlighting survey results that 58 percent of U.S. workers, an estimated 92 million people, shared that they can work remotely at least part of the time, and that when employees are given the option to work remotely, 87 percent of employees chose to do so), https://www.mckinsey.com/industries/real-estate/our-insights/americans-are-embracing-flexible-work-and-they-want-more-of-it#/.

³⁸ See note 33, supra.

business activities that were unreported to the firm or a lifestyle that did not align with the associated person's compensation or production levels.

As firms are working in a progressively more digitized environment and operating under a system of controls that has become more centralized, FINRA has observed that in general, much of the work traditionally associated with an on-site inspection takes place before the on-site visit. For example, efforts to investigate potential undisclosed outside business activities or evidence of a registered person's lifestyle that may not be commensurate with the person's revenue production at the firm are accomplished through general internet searches of social media and public records; and irregular customer account activity, trading activity, and written communications are reviewed through the firm's electronic systems. The pandemic has revealed the pragmatism of satisfying Rule 3110(c)(1) through an on-site process in a technological environment that is vastly different from the environment in which the office review requirement was expanded in the 1980s. In engagement with industry representatives, particularly in recent years, some firms have shared with FINRA that the variance between their rates of inspection findings through an on-site process and findings through a remote process were not material. These firm observations align with the observations some commenters conveyed in response to the Initial Rule Filing.³⁹ Moreover, FINRA's experience examining firms' remote inspection programs also aligns with these observations.

In 2022, FINRA examined several firms, including those that operate under an independent contractor business model and others with branch office networks, to test their compliance with Rule 3110.17, the temporary provision that provides firms the

³⁹ See Exhibit 2c.

option, subject to the specified requirements under that supplementary material, to complete their calendar year inspection obligations remotely without an on-site visit to the office or location.⁴⁰ The targeted examinations assessed firms' implementation of their remote inspection processes and the effectiveness of their supervisory systems. FINRA found that, in general, these systems were effective in supporting remote branch office inspections. Of the examinations completed for Rule 3110.17 compliance, approximately 43% resulted in no findings and 21% identified findings that were operational in nature and did not raise concerns of customer harm, while 36% of the examinations remain ongoing. In addition to engaging in ongoing surveillance of activities, FINRA observed that firms were using, among other inspection tools, "pre-audit" questionnaires to assess the risk level of a branch office and determine the frequency of inspections (remote or on-site) on an announced or unannounced basis. In addition, FINRA observed firms making broad use of technology to supervise the activities of their associated persons remotely to: identify undisclosed private securities transactions and outside business activities; identify problematic electronic communications; surveil trades and movements of customer assets; conduct interviews with supervisors and other associated persons assigned to the office or location; take and record online office tours; and review associated persons' computers in real-time using tools such as remote desktop software. FINRA's overall examination findings in recent years across all firm examinations conducted during the period in which firms were

⁴⁰ See Securities Exchange Act Release No. 96241 (November 4, 2022), 87 FR 67969 (November 10, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-030). See also Item 3.(a)III.B. for further discussion.

conducting fully remote inspections or operating in a fully remote or hybrid work environment, have remained within the bounds of general norms.⁴¹

III. The Emergence of Remote Inspections as a New Approach to Evaluate Under Rule 3110(c)(1)

A. The 2017 Proposal to Allow Remote Inspections and the Impact from the Pandemic

Even prior to the pandemic, in 2017, FINRA considered a proposal to give firms the option of satisfying the inspection requirement remotely for “qualifying offices” that met specified criteria.⁴² However, the pandemic significantly changed the industry’s standard business operations, forcing member firms to adapt to a full remote work environment and implement remote supervisory practices.⁴³ Consequently, FINRA deferred the 2017 Proposal in light of the pressing need to address significant operational disruptions to the securities industry, regulators, impacted member firms, investors and other stakeholders. During this exigent period, FINRA responded to numerous issues and questions that urgently arose.⁴⁴ Following up on these actions, FINRA published Notice 20-42 to gain a broader understanding of member firm experiences during the pandemic.

⁴¹ FINRA notes that examination findings that were attributable to complying with a new regulation adopted by the SEC, for example, are separate from this general view.

⁴² See Regulatory Notice 17-38 (November 2017) (“2017 Proposal”). FINRA requested comment on a proposed amendment to Rule 3110 to allow remote inspections of “qualifying offices” that met specified criteria, in lieu of on-site inspections of such offices and locations. In general, many of the comment letters FINRA received expressed support for the underlying concept of remote inspections and offered recommendations on specific criteria to broaden the potential population of qualifying offices.

⁴³ See generally Notice 20-16.

⁴⁴ See note 32, supra.

This notice sought feedback from firms about their experiences in a range of areas, including how member firms' operations and business models changed during the public health crisis and how they might further evolve as the pandemic persisted. Other initiatives included sharing general practices of firms in transitioning and supervising in the remote work environment, and providing temporary relief to member firms from specified FINRA rules and requirements. In particular, to give firms an opportunity to better manage their operational challenges and redirect resources attendant to fulfilling their inspection obligations, FINRA provided temporary relief to member firms pertaining to Rule 3110(c).⁴⁵

B. Temporary Amendments to the Inspection Requirement Under Rule 3110(c)

The ensuing pandemic-related operational changes made it impracticable for member firms to conduct the on-site inspection component of Rule 3110(c) at most offices and locations because of limitations on travel to geographically dispersed OSJs, branch offices, and non-branch locations. In response to the logistical challenges, FINRA extended the time by which member firms were required to complete their calendar year 2020 inspection obligations under Rule 3110(c) to March 31, 2021 with the expectation that the extension did not relieve firms from the on-site portion of the inspections of their offices and locations.⁴⁶ However, health and safety concerns remained unabated and with many restrictive measures still in place as calendar year

⁴⁵ See Rules 3110.16 and 3110.17.

⁴⁶ See Securities Exchange Act Release No. 89188 (June 30, 2020), 85 FR 40713 (July 7, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-019).

2020 was ending, FINRA adopted Rule 3110.17 to provide member firms the option, subject to specified requirements under the supplementary material, to complete remotely their calendar year inspection obligations without an on-site visit to the office or location.⁴⁷ This relief was repeatedly extended and currently, Rule 3110.17 will automatically sunset on December 31, 2023.⁴⁸

Through comments to the 2017 Proposal, Notice 20-42, the various temporary amendments to Rule 3110, and other engagement with industry representatives, firms have highlighted that technological advances, as described above, have allowed a large portion of the inspection work to be conducted electronically, prior to any on-site visit to the office and location, and that in general, inspecting offices and locations in accordance with Rule 3110(c)(1) through a compulsory on-site process is not an efficient and effective use of limited firm resources.⁴⁹

⁴⁷ See Securities Exchange Act Release No. 90454 (November 18, 2020), 85 FR 75097 (November 24, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-040).

⁴⁸ See Securities Exchange Act Release No. 93002 (September 15, 2021), 86 FR 52508 (September 21, 2021) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2021-023); Securities Exchange Act Release No. 94018 (January 20, 2022), 87 FR 4072 (January 26, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-001); and Securities Exchange Act Release No. 96241 (November 4, 2022), 87 FR 67969 (November 10, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-030).

⁴⁹ In response to FINRA's proposed rule changes associated with Rule 3110.17, one commenter made similar points about the physical, on-site piece of the inspection process. This commenter stated that pre-pandemic, an on-site inspection of a branch office typically consisted of reviewing the lobby area of the office, the back office (to review safe contents, sales literature, daily operations logs containing account applications), signage, and the physical security of the office. See Letter from Carrie L. Chelko, Chief Compliance Officer, Fidelity Brokerage Services LLC ("Fidelity Brokerage") & Norman L. Ashkenas, Chief Compliance

Rule 3110.17 was adopted in the midst of the pandemic, when many offices and locations were forced to close to allow employees to carry on with their responsibilities from alternative worksites. This relief has been extended as pandemic concerns continued.⁵⁰ FINRA recognizes that the pandemic has changed the conventional thinking on where work is conducted and this shift in the workforce landscape will unlikely revert to the model that existed pre-pandemic.

C. The 2022 Remote Inspections Pilot Program Rule Filing (File No. SR-FINRA-2022-021)

Based on the foregoing, in July 2022, FINRA filed the Initial Rule Filing to amend Rule 3110 to adopt proposed Rule 3110.18 to establish a voluntary, three-year remote inspection pilot program, under terms based largely on Rule 3110.17, but with significant safeguards that would have allowed FINRA the opportunity to collect specified data from pilot program participants to evaluate their experiences and inspection findings in a uniform, comparable manner in the context of then emerging hybrid work model. The SEC twice published the Initial Rule Filing for public comment, which elicited responses from many individuals, broker-dealers, law schools, and trade organizations and other associations, including the Securities Industry and Financial

Officer, National Financial Services LLC (“NFS”) and Fidelity Distributors Company LLC (“Fidelity Distributors”), to Vanessa Countryman, Secretary, SEC, dated July 28, 2020, in response to File No. SR-FINRA-2020-019, <https://www.sec.gov/comments/sr-finra-2020-019/srfinra2020019-7488701-221389.pdf>, and Letter from Gail Merken, Chief Compliance Officer, Fidelity Brokerage, Janet Dyer, Chief Compliance Officer, NFS & John McGinty, Chief Compliance Officer, Fidelity Distributors, to Vanessa Countryman, Secretary, SEC, dated February 16, 2022, in response to File No. SR-FINRA-2022-001, <https://www.sec.gov/comments/sr-finra-2022-001/srfinra2022001-20116307-267950.pdf>.

⁵⁰ See note 48, supra.

Markets Association, the North American Securities Administrators Association, Inc. (“NASAA”) and the Public Investors Advocate Bar Association (“PIABA”).⁵¹ The SEC received over 30 comment letters during the course of the two comment periods.⁵² Most of the comment letters expressed support for the overall objectives of the proposal, and many commenters viewed the proposal as a step towards FINRA rule modernization, and having a positive impact on diversity and inclusion initiatives.⁵³ However, four commenters, which included NASAA and PIABA, raised concerns with the Initial Rule Filing.⁵⁴ NASAA and PIABA each submitted two comment letters expressing opposition to the Initial Rule Filing.⁵⁵ NASAA and PIABA asserted generally that the proposal would adversely impact investor protection due to, among other concerns: the adequacy and scope of the proposed pilot program’s controls—the exclusions and conditions—to address higher-risk conduct; the identification of technologies firms would use to conduct their inspections remotely; the fundamental change to the approach of supervision; monitoring for pilot program compliance; and the lack of data to fully support the effectiveness of remote inspections.⁵⁶

⁵¹ See Submitted Comments to File No. SR-FINRA-2022-021, <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021.htm>.

⁵² See note 51, *supra*.

⁵³ See Exhibit 2c.

⁵⁴ See Exhibit 2c.

⁵⁵ See note 51, *supra*.

⁵⁶ See Exhibit 2c.

FINRA submitted a letter responding to comments⁵⁷ and filed the Amended Rule Filing in December 2022.⁵⁸ The Amended Rule Filing proposed to: (1) add specific risk criteria that a member must consider in making its risk-based evaluation of an office or location; (2) expand the list of exclusions that would make a member ineligible to participate in the proposed pilot program; (3) expand the list of exclusions that would make a specific office or location of a member ineligible for a remote inspection; (4) add express conditions that a member must satisfy to be eligible to conduct remote inspections of any of its offices or locations; (5) add express conditions that a specific office or location of a member must satisfy to be eligible for a remote inspection; and (6) add a new provision to allow FINRA to make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the proposed pilot program for failing to comply with the requirements of proposed Rule 3110.18. The SEC subsequently published the Amended Rule Filing for public comment,⁵⁹ and during the third comment period, the SEC received four more comment letters, including a third letter from NASAA, stating that in general, while the Amended Rule Filing was an improvement to the proposed pilot program, it still needed more guardrails with respect to the risk assessment; written supervisory procedures; the firm level condition relating to surveillance and technology tools; the data and information collection requirement; and FINRA's determination of ineligibility for pilot

⁵⁷ See Exhibit 2c.

⁵⁸ See Exhibit 2b.

⁵⁹ See Securities Exchange Act Release No. 96520 (December 16, 2022), 87 FR 78737 (December 22, 2022) (Notice of Filing of Partial Amendment No. 1 to File No. SR-FINRA-2022-021).

participation.⁶⁰ On April 11, 2023, FINRA withdrew File No. SR-FINRA-2022-021 from the SEC to consider whether more guardrails and clarifications to the filing would be appropriate in response to concerns raised by commenters.⁶¹

IV. Proposed Voluntary, Three-Year Pilot Program for Remote Inspections

Proposed Rule 3110.18, which sets forth the terms of the proposed pilot program, would build largely on the terms of Rule 3110.17 and retain the key changes as proposed in the 2022 Remote Inspections Pilot Program Rule Filing, including the areas pertaining to the risk assessment, written supervisory procedures, the firm level condition relating to surveillance and technology tools, and FINRA’s determination of ineligibility for pilot participation.⁶² As detailed below, the proposed rule change would clarify proposed Rule 3110.18 in the areas pertaining to: (1) the frequency of FINRA’s data and information collection from pilot program participants, and the type of “findings” that would be part of the collection; and (2) the location level ineligibility criterion for market making and trading activities.

FINRA anticipates that the proposed pilot program will provide broader systemized information to supplement the information obtained through the FINRA examination process in an environment where offices and locations were closed. The information firms would be required to produce as a pilot program participant will help

⁶⁰ See Letter from Andrew Hartnett, President, NASAA, to Sherry R. Haywood, Assistant Secretary, SEC, dated January 12, 2023 (“NASAA III”), <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20154758-323090.pdf>.

⁶¹ See Exhibit 2d.

⁶² FINRA is also proposing technical changes that would include, among others, reorganizing the presentation of the proposed rule.

FINRA more accurately assess the overall impact and effectiveness of remote inspections.

FINRA is wholly dedicated to ensuring effective firm supervision as a bulwark against misconduct or misadventure that could harm investors. To this end, FINRA has been in the forefront of developing strong supervision standards for member firms. As FINRA emphasized in the proposed rule change to adopt Rule 3110.17, the responsibility of firms to supervise their associated persons on a day-to-day basis is a critical component of broker-dealer regulation.⁶³ FINRA remains committed to ensuring that firms maintain a strong, effective supervisory system, of which the inspection requirement in Rule 3110(c) is a component. Moreover, this inspection requirement is just one facet of a reasonably designed supervisory system; the inspection process is one of several critical components of the broad supervisory process required of member firms to effectively oversee all of their associated persons, regardless of location, compensation or employment arrangement, or registration status. FINRA believes at this time that the proposed pilot program is consistent with a firm's core responsibility, as set forth in Rule 3110, to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Thus, FINRA believes that the remote inspections pilot program's proposed controls and safeguards achieve a responsible balance preserving the investor protection objectives of the rule, while allowing FINRA and the industry to gather data to further evaluate the appropriate contours of the remote

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See note 47, supra.

inspection construct. FINRA of course welcomes the insights of commenters as FINRA strives to further articulate an effective firm supervisory process.

A. Scope (Proposed Rule 3110.18(a))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(a) would apply to the required inspections of OSJs, branch offices, and non-branch locations under the applicable provisions under Rule 3110(c)(1) for a pilot period of three years starting on the effective date, and expiring on a date that is three years after the effective date. If the proposed pilot program is not extended or Rule 3110.18, as may be amended, is not approved as permanent by the SEC, the proposed supplementary material would automatically sunset on a date that is three years after the effective date. In addition, proposed Rule 3110.18(a) would expressly state that members would not be able to participate in the proposed pilot program after it expires.

B. Risk Assessment (Proposed Rule 3110.18(b))

As described above, Rule 3110(c)(1) provides that an inspection of an office or location must occur on a designated frequency, and the periodicity of the required inspection varies depending on the classification of the location as an OSJ, branch office or non-branch location. Subject to the proposed provisions relating to written supervisory procedures, and the firm and location level requirements as described below, proposed Rule 3110.18(b)(1) would provide that a member firm may elect to conduct the applicable inspection of an office or location during the pilot period remotely, without necessarily an on-site visit for the office or location, when the member reasonably determines that the purposes of the rule can be accomplished by conducting such required

inspection remotely.⁶⁴ To address the concerns raised by commenters to the Initial Rule Filing that a firm might not appropriately consider certain higher risk criteria in conducting its risk assessment, the Amended Rule Filing added a non-exhaustive list of factors that a firm must consider and document. FINRA is proposing to retain, without substantive change, those terms under proposed Rule 3110.18(b).

1. Standards for Reasonable Review (Proposed Rule 3110.18(b)(1))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(b)(1) would provide that prior to electing a remote inspection for an office or location, rather than an on-site inspection, the firm must develop a reasonable risk-based approach to using remote inspections and conduct and document a risk assessment for that office or location. The assessment must document the factors considered, including the factors set forth in Rule 3110.12, and must take into account any higher risk activities that take place or higher risk associated persons that are assigned to that location. FINRA expects that higher risk factors at a particular location would cause a firm to conduct on-site inspections of such location. Further, under the proposed supplementary material, a member that is not eligible to conduct remote inspections under paragraphs (f) or (g) under proposed Rule 3110.18, pertaining to firm level and location level requirements, respectively, must conduct an on-site inspection of that office or location on the required cycle. Finally, notwithstanding the pilot program, a

⁶⁴ As described further below, a member firm that elects to participate in the proposed pilot program would be subject to the requirements of proposed Rule 3110.18 for a Pilot Year. See proposed Rule 3110.18(i).

member would remain subject to the other requirements and limitations of Rule 3110(c).⁶⁵

2. Other Factors to Consider for the Risk Assessment
(Proposed Rule 3110.18(b)(2))

Consistent with the Amended Rule Filing, FINRA is proposing to set forth a non-exhaustive list of factors that a firm must consider and document as part of the risk assessment. Proposed Rule 3110.18(b)(2) would provide that in addition to the requirements under proposed Rule 3110.18(b)(1), a member would be required to consider other factors in making its risk assessment for remotely inspecting an office or location. These factors would include, among others: (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. In addition, proposed Rule 3110.18(b)(2) would provide that, consistent with Rule 3110.12, members should conduct on-site inspections or make more frequent use of unannounced, on-site inspections for high-risk offices or locations or where there are indicators of irregularities or misconduct (i.e., "red flags:").

In response to the Amended Rule Filing, NASAA recommended that in the absence of an affirmative on-site inspection requirement, a firm should be required to document its reasons for not conducting an on-site inspection of an office or location,

⁶⁵ See notes 20 and 21, supra, and accompanying text.

particularly if high risk factors or red flags are identified, or the office or location is a private residence.⁶⁶ FINRA believes that Rule 3110.18(b), as proposed herein, reflects NASAA’s insight. As noted previously, FINRA emphasizes that the inspection requirement is but one part of a firm’s overall supervisory system, and that the inspection, whether done remotely or on-site under the proposed pilot program, would be held to the existing standards of review under Rule 3110.12. Those standards provide, in part, that based on the factors set forth under that supplementary material, members “may need to provide for more frequent review of certain locations.” FINRA notes that proposed Rule 3110.18(b) would continue to account for the existing standards for reasonable review under Rule 3110.12 and retain the requirement for a firm, before electing a remote inspection for an office or location, to develop a reasonable risk-based approach to using remote inspections for its offices or locations, and conduct and document a risk assessment. In conducting the assessment, a firm must document the factors considered, including the factors set forth in Rule 3110.12, and must take into account any higher risk activities that take place or higher risk associated persons that are assigned to that office or location, irrespective of whether such office or location is a private residence. FINRA expects a firm to carefully consider the proposed factors listed above and Rule 3110.12 for the risk assessment. The outcome of such assessment may raise red flags that should prompt a firm to consider, among other things, more frequent inspections of an office or location—be they remote or on-site—than the schedule set forth under Rule 3110(c)(1) (on an announced or unannounced basis). Further, FINRA notes that Rule 3130 (Annual Certification of Compliance and Supervisory Processes) requires member firms to have

⁶⁶ See NASAA III.

processes to establish, maintain, review, test, and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable FINRA rules, Municipal Securities Rulemaking Board rules, and federal securities laws and regulations. FINRA expects firms to consider proposed Rule 3110.18 as part of their annual certification process under Rule 3130.

C. Written Supervisory Procedures for Remote Inspections (Proposed Rule 3110.18(c))

As part of an effective supervisory system tailored specifically to the member firm's business and the activities of all its associated persons, a member must establish and maintain written procedures.⁶⁷ Paragraph (1) (General Requirements) under Rule 3110(b) (Written Procedures) provides that a member must establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

Currently, Rule 3110.17(b) expressly provides that consistent with a member's obligation under Rule 3110(b)(1), a member that elects to conduct each of its inspections in the specified calendar years remotely must amend or supplement its written supervisory procedures to provide for remote inspections that are reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with applicable FINRA rules. In addition, under Rule 3110.17(b), reasonably designed procedures for conducting remote inspection of offices or locations should include, among other things, a description of the methodology,

⁶⁷ See Rule 3110(a)(1); see generally Notice 99-45 and Regulatory Notice 18-15 (April 2018).

including technologies permitted by the member, that may be used to conduct remote inspections. Further, such procedures should include the use of other risk-based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.⁶⁸ To underscore the importance of Rule 3110(b)(1) in the context of the proposed pilot program, FINRA proposed in the 2022 Remote Inspection Pilot Program Rule Filing to add to the elements currently described under Rule 3110.17(b) an express provision that the firm must adopt written supervisory procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. In addition, a firm's written supervisory procedures should also include the factors considered in the risk assessment made for each applicable office or location pursuant to proposed Rule 3110.18(b).

In response to this proposed provision, NASAA stated that a firm's written supervisory procedures should require more prescriptive details such as specifying the technologies a firm would be using "for what purposes[,]" and providing evidence of firm personnel's accessibility to and proficiency with those technologies; describing the circumstances under which a firm would conduct an on-site inspection in the "ordinary

⁶⁸ Offices or locations that may present a higher risk profile would include, for example, those that have associated persons engaging in activities that involve handling customer funds or securities, maintaining books and records as described under applicable federal securities laws and FINRA rules, order execution as principal or other activities that may be more susceptible to higher risks of operational or sales practice wrongdoing, or have associated persons assigned to an office or location who may be subject to additional or heightened supervisory procedures.

course” and as a result of risk indicators and red flags; indicating “whether the firm [intended] to conduct unannounced inspections, how the firm intend[ed] to do so remotely, and whether certain factors might influence the firm’s decision to do so in particular [circumstances];” and describing “how [a] firm will use its remote inspection procedures to control for the possibility of active deception.”⁶⁹

After considering the specific details recommended by NASAA, FINRA is proposing to largely retain the terms as proposed in the 2022 Remote Inspections Pilot Program Rule Filing as consistent with the tenor of other provisions of Rule 3110. Proposed Rule 3110.18(c) would provide that consistent with a member’s Rule 3110(b) obligations, a member that elects to participate in the proposed remote inspection pilot program must adopt written supervisory procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Further, under the proposed provision, reasonably designed procedures for conducting remote inspections of offices or locations must address, among other things: (1) the methodology, including technology, that may be used to conduct remote inspections; (2) the factors considered in the risk assessment made for each applicable office or location pursuant to proposed Rule 3110.18(b); (3) the procedures specified in paragraphs (h)(1)(G) and (h)(4) under proposed Rule 3110.18.⁷⁰ and (4) the use of other risk-based

⁶⁹ See NASAA III.

⁷⁰ The areas specified in proposed Rule 3110.18(h)(1)(G) include the procedures for escalating significant findings, new hires, supervising brokers with a significant history of misconduct, outside business activities and doing business as designations, and the areas specified in proposed Rule 3110.18(h)(4) include data and information collection, and transmission.

systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.

While the details identified by NASAA may be useful elements for firms to consider in devising reasonably designed procedures, FINRA believes that proposed Rule 3110.18(c), read in conjunction with proposed Rule 3110.18(d), as described below, would provide the appropriate level of direction for firms with respect to technology, the areas that written policies and procedures must address, and the use of other risk-based systems while also staying aligned with the principles underlying Rule 3110. FINRA expects firms to take into account the factors affecting their systems and businesses in crafting reasonably designed policies and procedures to achieve the purposes of the rule.

D. Effective Supervisory System (Proposed Rule 3110.18(d))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, FINRA is proposing to retain the terms of Rule 3110.17(c), without substantive change, in proposed Rule 3110.18(d). Similar to Rule 3110.17(c), proposed Rule 3110.18(d) would expressly reiterate the principle that the requirement to conduct inspections of offices and locations is one part of the member's overall ongoing obligation to have an effective supervisory system, and therefore a member must maintain its ongoing review of the activities and functions occurring at all offices and locations whether or not the member conducts inspections remotely. In addition, proposed Rule 3110.18(d) would provide that a member's remote inspection of an office or location would be held to the same standards for review applicable to on-site inspections as set forth under Rule 3110.12.⁷¹

⁷¹ See note 22, supra, and accompanying text.

Further, proposed Rule 3110.18(d) would provide that where a member's remote inspection of an office or location identifies any indicators of irregularities or misconduct (i.e., "red flags"), the member may need to impose additional supervisory procedures for that office or location, or may need to provide for more frequent monitoring or oversight of that office or location, or both, including potentially a subsequent physical, on-site visit on an announced or unannounced basis.

E. Documentation Requirement (Proposed Rule 3110.18(e))

In general, Rule 3110(c)(2) imposes various documentation requirements for inspections, including maintaining a written record of the date upon which each inspection is conducted. Currently, Rule 3110.17(d) requires supplemental documentation by a member that avails itself of the remote inspection option. The member must maintain and preserve a centralized record for each of calendar years specified in the supplementary material that separately identifies: (1) all offices or locations that had inspections that were conducted remotely; and (2) any offices or locations that the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in Rule 3110.17(c). A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection.

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, FINRA is proposing to incorporate, without substantive change, the terms of Rule 3110.17(d) in proposed Rule 3110.18(e), while making two clarifying changes. One change would be to reference that the centralized record must be for each of the "pilot years" (as defined in

proposed Rule 3110.18(1)), and the other change would be to clarify that a member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection, including whether an on-site inspection was conducted at such office.

F. Firm Level Requirements (Proposed Rule 3110.18(f))

In the Initial Rule Filing, FINRA proposed to exclude some member firms from participating in the proposed pilot program. The categories of ineligibility were events or activities of a member firm that FINRA explained were more likely to raise investor protection concerns based on the firm's record of specified regulatory or disciplinary events. Some commenters to the Initial Rule Filing expressed general concerns relating to the adequacy and scope of those proposed controls—the exclusions and conditions—to address higher risk conduct.⁷² In response to those concerns, the Amended Rule Filing proposed expanding the list of controls. The proposed rule change would retain, without substantive change, the criteria as set forth in the Amended Rule Filing.

1. Firm Level Ineligibility Criteria (Proposed Rule 3110.18(f)(1))

Under proposed Rule 3110.18(f)(1), a member firm would be ineligible to conduct remote inspections of any of its offices if any time during the pilot period, the member: (1) is or becomes designated as a Restricted Firm under Rule 4111⁷³ (proposed

⁷² See Exhibit 2c.

⁷³ In general, Rule 4111 (Restricted Firm Obligations) requires member firms that are identified as "Restricted Firms" to deposit cash or qualified securities in a segregated, restricted account; adhere to specified conditions or restrictions; or comply with a combination of such obligations. See generally Regulatory Notice

Rule 3110.18(f)(1)(A)); (2) is or becomes designated as a Taping Firm under Rule 3170⁷⁴ (proposed Rule 3110.18(f)(1)(B)); (3) receives a notice from FINRA pursuant to Rule 9557 regarding compliance with Rule 4110 (Capital Compliance), Rule 4120 (Regulatory Notification and Business Curtailment) or Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties) (proposed Rule 3110.18(f)(1)(C)); (4) is or becomes suspended from membership by FINRA (proposed Rule 3110.18(f)(1)(D)); (5) based on the date in the Central Registration Depository (“CRD®”)⁷⁵ had its FINRA membership become effective within the prior 12 months (proposed Rule 3110.18(f)(1)(E)); or (6) is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c) (proposed Rule 3110.18(f)(1)(F)).⁷⁶

Rules 4111 and 3170 expressly address firms that pose higher risks, and for that reason, those firms would be ineligible to participate in the proposed pilot program.

21-34 (September 2021) (announcing FINRA’s adoption of rules to address firms with a significant history of misconduct).

⁷⁴ In general, Rule 3170 (Tape Recording of Registered Persons by Certain Firms) requires a member firm to establish, enforce and maintain special written procedures supervising the telemarketing activities of all of its registered persons, including the tape recording of conversations, if the firm has hired more than a specified percentage of registered persons from firms that meet FINRA Rule 3170's definition of “disciplined firm.” See generally Regulatory Notice 14-10 (March 2014) (announcing FINRA’s adoption of consolidated rules governing supervision).

⁷⁵ CRD is the central licensing and registration system that FINRA operates for the benefit of FINRA, the SEC, other SROs, state securities regulators and broker-dealer firms. The information maintained in the CRD system is reported by registered broker-dealer firms, associated persons and regulatory authorities in response to questions on specified uniform registration forms. See generally Rule 8312 (FINRA BrokerCheck Disclosure).

⁷⁶ FINRA notes that the term “found” as used in this proposed criterion would carry the same meaning as Rule 4530.03 (Meaning of “Found”).

Further, FINRA believes that a member firm that is experiencing issues complying with its capital requirements or has been suspended from membership by FINRA is more likely to face significant operational challenges that may negatively impact the firm's inspection program. FINRA further believes that a firm that has been a FINRA member for less than 12 months is often still implementing its business plan and may not have sufficient experience to develop a sufficiently robust inspection program. With respect to a firm that is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c), FINRA believes such firms have demonstrated challenges in developing or maintaining robust inspection programs. Collectively, FINRA believes that these proposed ineligibility criteria would appropriately limit the potential population of pilot program participants to those firms that may be better positioned to conduct remote inspections.

2. Firm Level Conditions (Proposed Rule 3110.18(f)(2))

To further address commenters' concerns pertaining to the adequacy and scope of the proposed controls of the pilot program, the Amended Rule Filing proposed enhancing the controls with respect to books and records, and surveillance and technology tools. In that filing, FINRA explained that those conditions were appropriate to establish reasonable baseline requirements for remote inspections. FINRA reaffirms this view through this proposed rule change by retaining, without substantive change, the conditions set forth in the Amended Rule Filing.

a. Recordkeeping System (Proposed Rule 3110.18(f)(2)(A))

As part of the requirements in proposed Rule 3110.18(b) to develop a reasonable risk-based approach to using remote inspections, and to conduct and document a risk

assessment for each office or location, the member must, under proposed Rule 3110.18(f)(2)(A), have a recordkeeping system to make and keep current, and preserve records required to be made and kept current, and preserved under applicable securities rules and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110. In addition, such records may not be physically or electronically maintained and preserved at the office or location subject to the remote inspection, and the member has prompt access to such records.

b. Surveillance and Technology Tools (Proposed Rule 3110.18(f)(2)(B))

In response to the Initial Rule Filing, NASAA expressed general concern about the lack of detail on the technology firms use to conduct effective remote surveillance.⁷⁷ Many commenters, however, had countered with the view that advances in technology have facilitated remote surveillance, including inspections, with some commenters describing the technology that they leverage to effectively surveil and inspect offices and locations remotely.⁷⁸ Examples included the use of laptops connected to the firm's network; smart phones for live video calls; video conferencing technology; electronic notifications of shipments to and from an office or location; and internet searches of social media and public records.⁷⁹ To address NASAA's general concerns about surveillance and technology, the Amended Rule Filing provided that as part of the requirement to develop a reasonable risk-based approach to using remote inspections, and

⁷⁷ See Exhibit 2c.

⁷⁸ See Exhibit 2c.

⁷⁹ See Exhibit 2c.

the requirement to conduct and document a risk assessment for each office or location, the member must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each such office or location, and set forth a description of the types of tools (e.g., electronic surveillance of e-mail, electronic trade blotters, secure network connections). However, in response to the Amended Rule Filing, NASAA, while acknowledging that supervisory requirements are principles-based, suggested that FINRA should revise the proposed provision to establish a mandatory technology floor for participants in the proposed pilot program comprising the tools commenters listed as examples of effective technologies.⁸⁰

As noted above, FINRA is proposing to retain, without substantive change, the condition pertaining to surveillance and technology tools as set forth in the Amended Rule Filing, as consonant with the principle-based tenor of the rule. Under proposed Rule 3110.18(f)(2)(B), as part of the requirement to develop a reasonable risk-based approach to using remote inspections, and the requirement to conduct and document a risk assessment for each office or location, the member must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each such remotely supervised office or location. The proposed provision would provide that these tools may include but are not limited to: (1) firm-wide tools such as electronic recordkeeping systems, electronic surveillance of e-mail and correspondence, electronic trade blotters, regular activity-based sampling reviews, and tools for visual inspections; (2) tools specifically applied to such office or location based on the activities of associated persons, products offered, restrictions on the activity of the office or

⁸⁰

See NASAA III.

location (including holding out to customers and handling of customer funds or securities); and (3) system security tools such as secure network connections and effective cybersecurity protocols. FINRA believes that proposed Rule 3110.18(f)(2)(B) appropriately conveys a reasonable baseline requirement for remote inspections. FINRA maintains that it would not be appropriate to identify specific technology-based tools because of the evolving development and ongoing advances in technologies. Moreover, FINRA notes that proposed Rule 3110.18(c) would require a firm to adopt reasonably designed written supervisory procedures that must include, among other things, a description of the methodology, including the technology, that a firm may use to conduct remote inspections.

G. Location Level Requirements (Proposed Rule 3110.18(g))

In the Initial Rule Filing, FINRA had proposed several criteria that if met would render a member's office or location ineligible for remote inspection. The categories of ineligibility were events or activities of an associated person of the member firm that FINRA had explained were more likely to raise investor protection concerns based on the individual's record of specified regulatory or disciplinary events. Some commenters to the Initial Rule Filing expressed general concerns relating to the discretion provided to firms to make risk assessments as to whether an office or location could undergo a remote inspection.⁸¹ In response to those concerns, FINRA had expanded the list of events or activities that would deem a specific office or location of a member ineligible from participating in the pilot program. The proposed rule change would retain the

⁸¹ See Exhibits 2b and 2c.

criteria set forth in the Amended Rule Filing, but with one clarifying adjustment pertaining to an associated person who is a part of a member's trading desk.

1. Location Level Ineligibility Criteria (Proposed Rule 3110.18(g)(1))

Under proposed Rule 3110.18(g)(1), a member firm's office or location would be ineligible for a remote inspection if at any time during the period of the proposed pilot program, an associated person at such office or location is or becomes: (1) subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or state regulatory agency (proposed Rule 3110.18(g)(1)(A)); (2) statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a mandatory heightened supervisory plan under proposed Rule 3110.18(g)(1)(A) or otherwise as a condition to approval or permission for such association (proposed Rule 3110.18(g)(1)(B)); (3) subject to Rule 1017(a)(7)⁸² as a result of one or more associated persons at such location (proposed Rule 3110.18(g)(1)(C)); (4) one or more associated persons at such location has an event in the prior three years that required a "yes" response to any item in Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), 14C, 14D and

⁸² In general, Rule 1017(a)(7) requires a member firm to file a CMA when a natural person seeking to become an owner, control person, principal or registered person of the member firm has, in the prior five years, one or more defined "final criminal matters" or two or more "specified risk events" unless the member firm has submitted a written request to FINRA seeking a materiality consultation for the contemplated activity. Rule 1017(a)(7) applies whether the person is seeking to become an owner, control person, principal or registered person at the person's current member firm or at a new member firm. See generally Regulatory Notice 21-09 (March 2021) (announcing FINRA's adoption of rules to address brokers with a significant history of misconduct).

14E on Form U4⁸³ (proposed Rule 3110.18(g)(1)(D)); (5) one or more associated persons at such office or location is or becomes subject to a disciplinary action taken by the member that is or was reportable under Rule 4530(a)(2) (proposed Rule 3110.18(g)(1)(E));⁸⁴ or (6) the office or location handles customer funds or securities (proposed Rule 3110.18(g)(1)(G)).⁸⁵ These proposed criteria remain substantively unchanged from the Amended Rule Filing.

In the Amended Rule Filing, FINRA had also proposed a criterion that would make a member firm's office or location ineligible for a remote inspection if one or more associated persons at such office or location was "a part of the member's trading desk (e.g., engaging in market making activities or having authority to enter proprietary trades on behalf of the member or as agent for other parties)[.]"⁸⁶ In response to the Amended Rule Filing, one commenter conveyed that the proposed criterion was overly broad, and

⁸³ Form U4's Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a) elicit reporting of criminal convictions, and Questions 14C, 14D, and 14E pertain to regulatory action disclosures.

⁸⁴ Paragraph (a)(2) under Rule 4530 (Reporting Requirements) requires a member firm to report when an associated person of the member is the subject of any disciplinary action taken by the member involving suspension, termination, the withholding of compensation or of any other remuneration in excess of \$2,500, the imposition of fines in excess of \$2,500 or is otherwise disciplined in any manner that would have a significant limitation on the individual's activities on a temporary or permanent basis.

⁸⁵ In accordance with existing guidance, the meaning and interpretation of the term "handled" that currently appears in Rule 3110(f)(2)(A)(ii) would remain consistent in the proposed pilot program. See also Notice to Members 06-12 (March 2006).

⁸⁶ See Exhibit 2b.

overstated the risks presented by trade desk personnel.⁸⁷ FINRA is proposing to adjust this criterion. As adjusted, under proposed Rule 3110.18(g)(1)(F), a member firm's office or location would be ineligible for a remote inspection if at any time during the period of the proposed pilot program, an associated person at such office or location is engaged in proprietary trading, including the incidental crossing of customer orders, or the direct supervision of such activities.⁸⁸

2. Location Level Conditions (Proposed Rule 3110.18(g)(2))

To further address the concerns about the adequacy and scope of the proposed pilot program's controls, the Amended Rule Filing had proposed enhancing the controls with respect to electronic communications, correspondence and books and records.

FINRA is proposing to retain, without substantive change, the conditions set forth in the Amended Rule Filing. Under proposed Rule 3110.18(g)(2), as part of the requirement to develop a reasonable risk-based approach to using remote inspections, and the requirement to conduct and document a risk assessment for each office or location, the member must satisfy the following conditions: (1) electronic communications (e.g., e-mail) are made through the member's electronic system; (2) the associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with Rule 3110; and (3) no books or records of the member required to be made and kept current, and preserved under applicable securities laws and regulations,

⁸⁷ See Letter from Sandip Khosla, General Counsel, Two Sigma Securities, LLC, to Vanessa A. Countryman, Secretary, SEC, dated January 12, 2023, <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20154757-323056.pdf>.

⁸⁸ FINRA notes that this proposed criterion would encompass trading activity in any security, whether traded on a national securities exchange or over-the-counter.

FINRA rules, and the member's own written supervisory procedures under Rule 3110 are physically or electronically maintained and preserved at such office or location. FINRA believes that proposed Rule 3110.18(g)(2) appropriately conveys a reasonable set of conditions related to communications of associated persons and the creation and preservation of books and records at a specific office or location.

FINRA believes that the proposed location level ineligibility criteria are indicia of increased risk to investors at some office or locations, such that they should not be eligible for remote inspections in accordance with the proposed pilot program.

A member firm, or an office or location subject to one of the categorical restrictions would not be eligible for remote inspections, even if the firm's risk assessment concludes that a remote inspection would be appropriate. A member firm that meets one of these ineligibility criteria would not be able to participate in the proposed pilot program. If a member firm is eligible to participate in the proposed pilot program, but one of its offices or locations meets one of the location level ineligibility criteria, the member would be required to conduct an on-site inspection of that office or location on the required cycle. FINRA believes the proposed list of ineligibility categories is appropriately derived from existing rule-based criteria that are part of processes to identify firms that may pose greater concern (e.g., Rules 4111 and 3170) or associated persons that may pose greater concerns due to the specified activities and nature of disclosures of regulatory or disciplinary events on the uniform registration forms. FINRA believes that these objective categorical restrictions will provide safeguards that will help ensure that firms maintain effective supervisory procedures during the pilot period.

H. Data and Information Collection Requirement (Proposed Rule 3110.18(h))

1. Data and Information (Proposed Rule 3118.18(h)(1))

As noted above, Rule 3110.17 was adopted in the midst of the pandemic and operationalized in an environment in which many offices and locations were closed to the public. FINRA believes that the formalized, uniform collection of data is critical to allow FINRA to meaningfully assess the effectiveness of remote inspections to help shape potential permanent amendments to Rule 3110(c) that would optimize an inspection program in the evolving workplace environment. FINRA believes having a pilot program for remote inspections with appropriate conditions, limitations and documentation requirements in an environment that is settling into a hybrid workplace model would provide a clearer picture of the strengths and weaknesses of remote inspections, without compromising investor protection. Proposed Rule 3110.18(h), the terms of which are similar to those set forth in the 2022 Remote Inspections Pilot Program Rule Filing, would impose upon firms a data and information collection requirement as a condition for participating in the pilot program. On a quarterly frequency, participating firms would be required to collect and produce to FINRA, in a manner and format determined by FINRA, data consisting of separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations, consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110, for several categories. These categories include: (1) the total number of inspections—on-site and remote—completed during each calendar quarter;⁸⁹ (2) the number of those office or locations in

⁸⁹ See proposed Rule 3110.18(h)(1)(A), (B) and (C).

each calendar quarter that were subject to an on-site inspection because of a “finding,” (as described under proposed Rule 3110.18(h)(1) as a discovery made during an inspection that led to a remedial action or was listed on the member’s inspection report);⁹⁰ (3) the number of locations for which a remote inspection was conducted in the calendar quarter that identified a finding, the number of findings, and a list of the most significant findings;⁹¹ and (4) the number of locations for which a on-site inspection was conducted in the calendar quarter that identified a finding, the number of findings, a list of the most significant findings.⁹² In addition, firms would be required to provide FINRA their written supervisory procedures for remote inspections that account for: (1) escalating significant findings; new hires; supervising brokers with a significant history of misconduct; and outside business activities and “doing business as” (or DBA) designations.⁹³ Firms would be required to provide FINRA with a copy of these written

⁹⁰ See proposed Rule 3110.18(h)(1)(D).

⁹¹ See proposed Rule 3110.18(h)(1)(E). A “significant finding” would be one that should prompt the firm to take further action that could include escalation to the appropriate channels at the firm for further review, the result of which may be enhanced monitoring or surveillance of a particular event or activity through more frequent inspections (remotely or on-site), on an announced or unannounced basis, of the office or location, or other targeted reviews of the root cause of the finding. Examples of some findings that may prompt escalation or further internal review by the appropriate firm personnel include, among other things, the use of unapproved communication mediums, customer complaints, or undisclosed outside business activities or private securities transactions.

⁹² See proposed Rule 3110.18(h)(1)(F).

⁹³ See proposed Rule 3110.18(h)(1)(G)(i) through (iv).

supervisory procedures alongside the first delivery of the data points described above, and any subsequent amendments to such procedures for remote inspections.⁹⁴

In response to the Amended Rule Filing, NASAA suggested that firms should be required to provide FINRA with “‘all findings’ made during remote inspections, not only the ones the firm subjectively deems ‘most significant’[,]” contending that the discretion given to firms to make this determination would undermine the data and hinder FINRA’s ability to assess trends and developments.⁹⁵ FINRA believes that to require firms to provide “all findings” rather than the “significant findings” would yield an overly broad data set where it would be challenging to discern key trends in a meaningful way. Moreover, while Rule 3110(c)(2) specifies the areas that a firm must address in an inspection report, if applicable to the office or location being inspected, the rule does not impose any other content requirements of an inspection report. FINRA believes that pilot program participants, which FINRA would expect to reflect a variety of attributes (e.g., size, business model, organizational structure), should have the agency to assess their significant findings and report them to FINRA in the manner specified under the proposed rule. FINRA maintains that this approach would enhance FINRA’s ability to review a discrete set of data that would focus on key areas of concern to firms, which in turn, would help FINRA assess the effectiveness of remote inspections.

⁹⁴ See proposed Rule 3110.18(h)(1)(G).

⁹⁵ See NASAA III.

2. Additional Data and Information for Pilot Year 1, if Less Than Full Calendar Year (Proposed Rule 3110.18(h)(2)) and for Calendar Year 2019 (Proposed Rule 3110.18(h)(3))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(h)(2) would address the additional data and information requirements for Pilot Year 1 (as defined under proposed Rule 3110.18(l)), if such year covers a period that is less than a full calendar year. In such case, a member that elects to participate in the proposed pilot program would be required to collect the following data and information and provide such data and information to FINRA (in a manner and format FINRA determines) no later than December 31 of such first Pilot Year. For items (1) through (3) below, a member would be required to provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110: (1) the number of locations with an inspection completed during the full calendar year of the first Pilot Year; (2) the number of locations in item (1) that were inspected remotely during the full calendar year of the first Pilot Year; and (3) the number of locations in item (1) that were inspected on-site during the full calendar year of the first Pilot Year. This additional data and information would provide FINRA the ability to capture, in the aggregate, complete inspection counts—total number of Rule 3110(c)(1) inspections (remote and on-site)—for the entire calendar year in addition to the more detailed data and information requirements under proposed Rule 3110.18(h)(1).

In response to the Amended Rule Filing, NASAA recommended that firms be required to provide FINRA with the information specified in the proposed provision relating to data and information collection to cover the most recent 12-month period

during which the firm conducted in-person inspections under Rule 3110(c). FINRA agrees with this approach. Thus, in addition to the data and information requirement under paragraphs (h)(1) and (h)(2) to proposed Rule 3110.18, proposed Rule 3110.18(h)(3) would require a pilot program participant to collect and provide to FINRA calendar year 2019 data and information no later than December 31 of Pilot Year 1 (as defined under proposed Rule 3110.18(l)). For items (1) and (2) below, a member would be required to provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110: (1) the number of locations with an inspection completed during calendar year 2019; and (2) the number of locations in item (1) where findings were identified, the number of those findings and a list of the most significant findings. This additional data and information covering calendar year 2019, when firms conducted their inspections solely on-site, would provide FINRA with some baseline data and information about on-site inspections immediately preceding the pandemic.

3. Written Policies and Procedures (Proposed Rule 3110.18(h)(4))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(h)(4) would remind firms of the general requirement to establish, maintain and enforce written policies and procedures that are reasonably designed to comply with the data and information collection, and transmission requirements of the proposed pilot program.

I. Election to Participate in Remote Inspections Pilot Program
(Proposed Rule 3110.18(i))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(i) would set forth the manner in which a firm would notify FINRA of the firm's election to participate in the proposed pilot program and to withdraw from it. The proposed rule would provide that FINRA may, in exceptional cases and where good cause is shown, waive the applicable timeframes described below for the required opt-in or opt-out notices.

Proposed Rule 3110.18(i) would require a firm, at least five calendar days before the beginning of such Pilot Year, to provide FINRA an "opt-in notice" in the manner and format determined by FINRA. By providing such opt-in notice to FINRA, the firm agrees to participate in the proposed pilot program for the duration of such Pilot Year and to comply with the requirements of Rule 3110.18.⁹⁶ A firm that provides the opt-in notice for a Pilot Year would be automatically deemed to have elected and agreed to participate in the Remote Inspections Pilot Program for subsequent Pilot Years (i.e., Pilot Year 2, Pilot Year 3, and Pilot Year 4, if applicable) until the pilot program expires. Further, proposed Rule 3110.18(i) would describe the notice requirement for a firm to withdraw from the proposed pilot program. A firm would be required to provide FINRA with an "opt-out notice" at least five calendar days before the end of the then current Pilot Year.

By way of example, a firm that provides FINRA an opt-in notice on June 26 to join Pilot Year 1 that begins on July 1 would be automatically deemed to continue

⁹⁶ A firm that participates in a Pilot Year would be committed to complying with the terms of proposed Rule 3110.18 for that Pilot Year.

participating in Pilot Year 2 unless the firm provides FINRA the required opt-out notice no later than December 26 of Pilot Year 1. To continue with this example, a firm that was automatically deemed to participate in Pilot Year 2 and determines in mid-Pilot Year 2 that it does not want to automatically continue into Pilot Year 3 could elect to withdraw from Pilot Year 3 if it provides FINRA an opt-out notice at least five calendar days before the end of Pilot Year 2. However, because Pilot Year 2 is already underway, the firm would be required to complete Pilot Year 2 in accordance with proposed Rule 3110.18.

FINRA believes that this proposed operational aspect of the program would not only establish a cohesive process in which firms and FINRA may manage program participation but also lend some continuity in data and information collection that would support FINRA's assessment and evaluation of the experiences of pilot program participants.

J. Failure to Satisfy Conditions (Proposed Rule 3110.18(j))

Consistent with 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(j) would address a situation in which a firm fails to satisfy terms of the proposed pilot program. The proposed paragraph would provide that a firm that fails to satisfy the conditions of Rule 3110.18, including the requirement to timely collect and submit the data and information to FINRA as set forth in proposed Rule 3110.18(h), would be ineligible to participate in the pilot program and must conduct on-site inspections of each office and location on the required cycle in accordance with Rule 3110(c).

K. Determination of Ineligibility (Proposed Rule 3110.18(k))

To address commenters' concerns pertaining to monitoring for compliance with the proposed pilot program, the Amended Rule Filing had proposed a provision to allow FINRA to make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the proposed pilot program if the member fails to comply with the requirements of the proposed pilot program. The proposal further provided that FINRA would provide written notice to the member of such determination and such member would no longer be eligible to participate in the proposed pilot program and would be required to conduct on-site inspections of required offices and locations in accordance with Rule 3110(c). In the Amended Rule Filing, FINRA had explained that this authority would both align with FINRA's examination and risk monitoring programs for member firms and registered persons and allow FINRA to more effectively assess higher risk. In response to the Amended Rule Filing, NASAA stated that the proposed provision should be expanded broadly to provide FINRA the ability to make such a determination if it finds that a firm "fail[ed] to comply with the requirements of applicable laws, rules, and regulations related to supervision of associated persons[,]" stating that this broad scope would provide the appropriate level of flexibility "to protect investors from misconduct and lax supervisory practices."⁹⁷

FINRA believes that the proposed provision is sufficiently broad in scope for purposes of the proposed pilot program. FINRA reiterates that the purpose of the proposed three-year pilot program, which is voluntary, is to study the effectiveness of remote inspections in accordance with Rule 3110(c)(1) as part of a reasonably designed

⁹⁷ See NASAA III.

supervisory system. Consistent with the Amended Rule Filing, FINRA is proposing to retain, without substantive change, proposed Rule 3110.18(k) under the described terms.

L. Definitions (Proposed Rule 3110.18(l))

Consistent with 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(l) would set forth the meanings underlying “Pilot Year” to explain the duration of the proposed pilot program. Under proposed Rule 3110.18(l), a “Pilot Year” would mean the following: (1) Pilot Year 1 would be the period beginning on the effective date of the proposed pilot program and ending on December 31 of the same year; (2) Pilot Year 2 would mean the calendar year period following Pilot Year 1, beginning on January 1 and ending on December 31; and (3) Pilot Year 3 would mean the calendar year period following Pilot Year 2, beginning on January 1 and ending on December 31. Finally, if applicable, where Pilot Year 1 covers a period that is less than a full calendar year, then Pilot Year 4 would mean the period following Pilot Year 3, beginning on January 1 and ending on a date that is three years after the effective date.

M. Sunset of Rule 3110.17 (Proposed Rule 3110.18(m))

As noted above, Rule 3110.17 is set to expire on December 31, 2023.⁹⁸ FINRA will submit a separate rule filing if, during the pendency of the SEC’s determination of whether to approve or disapprove this proposed rule change, FINRA seeks to extend the duration of Rule 3110.17 beyond the current term. Proposed Rule 3110.18 would expressly account for the possibility of overlapping provisions if the proposed pilot program becomes effective while Rule 3110.17 is also in effect. Proposed paragraph (m), which is nearly identical to the provision set forth in the 2022 Remote Inspections Pilot

⁹⁸ See note 48, supra.

Program Rule Filing, would provide that if Rule 3110.17 has not already expired by its own terms (on December 31, 2023 or as the case may be, on an extended date), it would automatically sunset on the effective date of proposed Rule 3110.18.

Consistent with the principles set forth in prior guidance, FINRA expects members to establish reasonably designed inspection programs. The proposed pilot program for remote inspections does not alter the core obligation of a member firm to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.⁹⁹ As part of the inspection planning process, FINRA expects members to continue with their ongoing supervision, including risk analysis of the activities and functions occurring at all offices or locations. While the option to conduct remote inspections in accordance with proposed Rule 3110.18 provides greater choice in how to effectively supervise some offices or locations, a member must continue to consider the factors described in Rule 3110.12, along with the activities taking place there. This analysis may require the member to conduct a physical, on-site inspection of an office or location. Where there are indications of problems or red flags at any office or location, FINRA expects members to investigate them as they would for any other office or location subject to Rule 3110(c), which may include an unannounced, on-site inspection of the office or location. FINRA is committed to diligently monitoring the impacts of remote inspections on a firms' overall supervisory systems and reviewing the data over the life of the proposed pilot program to assess how firms apply the

⁹⁹ See Rule 3110(a).

flexibility provided by the pilot program while maintaining an effective supervisory program.

V. FINRA's Monitoring and Compliance with Proposed Rule 3110.18

A. Overview of FINRA's Data-Driven, Risk-Based Regulatory Framework

FINRA's data-driven regulatory programs are integrated among various FINRA departments, and the data and information FINRA currently collects from its member firms helps provide FINRA with a holistic view of firm risk management. FINRA's Examinations and Risk Monitoring Program, which is a part of FINRA's Member Supervision Department, is a critical component of FINRA's regulatory operations, and one of the many ways in which FINRA oversees the activities of member firms and its associated persons with the goal of detecting, deterring, and addressing activities that may cause investor harm or adversely impact market integrity.¹⁰⁰

FINRA's Risk Monitoring is organized by the primary business model of member firms¹⁰¹ and serves as a point of contact for FINRA member firms on a range of topics that may include, among others, financial and business conduct requirements and firm submissions (e.g., FOCUS filings, Rule 4530 filings, other reporting requirements), published guidance, and new FINRA rules. This relationship allows Risk Monitoring to cultivate a thorough understanding of the business activities and operations of each firm they monitor. This knowledge, along with the data FINRA collects serves FINRA by

¹⁰⁰ See generally FINRA Examination and Risk Monitoring Programs, <https://www.finra.org/rules-guidance/key-topics/finra-examination-risk-monitoring-programs>.

¹⁰¹ The five business models are Capital Markets, Carrying and Clearing, Retail, Trading and Execution, and Diversified.

providing ongoing awareness and analysis of member firm activities, including business lines, operations, products, and controls. This proactive monitoring, with Risk Monitoring as the point of contact for member firms, enables FINRA to implement a risk-based regulatory program that focuses resources and regulator responses on concerning risks. This assessment methodology plays a role in many aspects of FINRA's regulatory programs, including FINRA's Examinations in the preparation of firm examinations. The type of examination may depend upon the firm profile that is created by a number of attributes, including among others, business model, size, the products offered, and disciplinary history of the firm and its registered persons. The areas of review in an examination may also be influenced by the adoption of a new FINRA rule and any accompanying guidance or interpretation.

As described above, the terms of proposed Rule 3110.18 include several rule-based or reportable criteria, or information that is electronically captured that FINRA can readily monitor through Risk Monitoring and Examinations. These criteria relate to Rules 1017(a)(7), 3170, 4111, and 9557, the suspension of FINRA membership, or a FINRA membership that has been effective for less than 12 months, among other criteria set forth in the proposed supplementary material. Activity-based criteria such as market-making and trading activities, and the handling of customer funds or securities can also be surveilled through firm submissions, and other data sources and internal systems.

FINRA recognizes that firms are using increasingly sophisticated technology and analytic techniques to synthesize data in ways not previously possible to identify indicators of possible rule violations and associated person misbehavior. To keep pace with the technological environment, FINRA's regulatory programs are also data driven,

and FINRA uses its data and information (e.g., Forms U4 and U5, regulatory tips, transaction reporting, and other internal and externally-acquired data), gathered, in part, through advanced analytics, to better identify and address risks that can be marked not only to a member firm, but also to a registered person. The picture that the data and information reveal may initiate an examination separate from the firm's routine examination or, through Risk Monitoring, further inquiry with the firm.

In the context of the proposed remote inspections pilot program, FINRA would use the risk markers identified using its analytic techniques to inform FINRA's Risk Monitoring and Examinations' assessment of whether FINRA should examine an office or location, and in turn, examine a firm's reasonableness determination to conducting remote inspections rather than an on-site inspection for that office or location. Some risk markers may include, among others, CRD disclosures, the number and types of OBAs of registered persons at a specific office or location, the existence and type of investor harm events that have occurred for individuals at an office or location, the historical results and frequency of FINRA's examination of an office or location, and the percentage of senior investors in the county in which the office or location reside, among others. Relatedly, FINRA is able to leverage this data and information when assessing the reasonableness of a firm's supervision, including their determination to inspect an office or location through a remote process, rather than an on-site process. For example, if the data and information identify an office or location with a concentration of OBAs or investor harm events and review of the firm's remote inspection program does not appear to account for OBAs or sales risks, there may be an overall weakness in the firm's inspection program, irrespective of whether the inspection is done remotely or on-site. As with any new

process or rule, FINRA anticipates undertaking a careful review of firm compliance with proposed Rule 3110.18. FINRA is engaged in ongoing efforts to enhance its regulatory programs, with a sustained focus on effectively identifying and addressing areas of risk by firm and registered person. Several of FINRA's key functions provide early warning indicators of potential problems, which FINRA leverages in its regulatory oversight of firms. In the context of reviewing a firm's remote inspections program, one indicator in this evaluation may be whether the firm is identifying risk indicators that are similar to those that FINRA is detecting.

B. FINRA's Use of the Data and Information Collected in
Accordance with Proposed Rule 3110.18(h)

In general, proposed Rule 3110.18(h) would require a pilot program participant to provide FINRA with specified data and information (in an aggregated form), including written supervisory procedures for remote inspections, that FINRA believes would complement FINRA's existing regulatory intelligence as part of the larger effort to gauge the effectiveness of remote inspections as part of a reasonably designed supervisory system. For purposes of its regulatory programs and if appropriate, FINRA may, after some experience with the data and information collected, extrapolate trends and practices in this area that could result in future rulemaking or updated guidance about inspections generally.

As noted in Item 2 of this filing, if the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁰² which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The terms of the proposed voluntary, three-year remote inspection pilot program, while based largely on the terms of Rule 3110.17, which has been operational since the latter part of 2020 and is set to automatically sunset on December 31, 2023,¹⁰³ would include important safeguards that would require individual risk assessments of each office, supplemental written supervisory procedures related to remote inspections, documentation requirements and obligations to share data with FINRA to allow for assessment of the pilot program. The proposed rule change is intended to provide firms that are operating in a hybrid work environment the option to conduct remote inspections of their offices and locations, subject to specified conditions, while maintaining effective supervision. FINRA believes that the proposed pilot program would provide FINRA the appropriate amount of time and population sample to better evaluate the use of remote inspections in the unfolding office work environment. FINRA believes the proposed pilot program, with the proposed safeguards and controls, will provide firms more flexibility to adapt to changing work conditions. The proposed pilot program would aid in FINRA's assessment of the effectiveness of a flexible remote inspection option and its

¹⁰² 15 U.S.C. 78o-3(b)(6).

¹⁰³ See note 48, supra.

utility in an environment that is increasingly moving to hybrid workplace models, without compromising investor protection.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to the current baseline, and the alternatives FINRA considered in assessing how best to meet FINRA's regulatory objectives.

A. Regulatory Need

The proposed pilot program would serve two purposes. First, it would mitigate potential disruptions to the hybrid work arrangements that have developed during the pandemic. In particular, for participating members, the proposed pilot program would limit the increase in aggregate inspection costs, and the resulting incentive to reduce the number and type of work locations, that would occur when temporary relief provided during the pandemic expires.¹⁰⁴ The proposed pilot program would not eliminate the

¹⁰⁴ According to the April Survey of Working Arrangements and Attitudes (SWAA), post-COVID, many employers are planning to allow employees to work from home approximately 2.2 days per week, on average. See Jose Maria Barrero, Nicholas Bloom, Shelby Buckman & Steven J. Davis, SWAA February 2023 (February 12, 2023), https://wfhrefsearch.com/wp-content/uploads/2023/02/WFHResearch_updates_February2023.pdf. The SWAA is a monthly survey with respondents that are working-age persons in the United

need for such adjustments, but it would allow member firms to focus their on-site inspections on riskier locations.

The proposed pilot program would also allow FINRA to assess the benefits and costs of allowing some element of remote inspection of branch offices and non-branch locations, under specified conditions, in the post-pandemic world. FINRA would obtain information from participating members on certain elements of the risk-based approach that they implement, the type and frequency of inspections, and certain outcomes conditional on the type and frequency of inspections, as well as the type of office or location inspected.

B. Economic Baseline

The economic baseline for the proposed rule change includes both current and foreseeable workforce arrangements and business practices, including those that were first developed during the pandemic and have been modified since. In particular, the economic baseline includes the innovations, and investments in communication and surveillance technology, that have supported and continue to support supervision in the remote work environment.¹⁰⁵ These innovations and investments were developed during the temporary relief allowing remote inspections in Rule 3110.17, and the temporary

States that had earnings of at least \$10,000 in 2019. Further details about this survey can be found in <https://wfhresearch.com>.

¹⁰⁵ The pandemic propelled increased reliance on technology solutions in the remote work environment. A McKinsey survey in late 2020 found that, overall, firms had accelerated their adoption of technology, with large accelerations in the implementation of changes to increase remote working and collaboration, as well the use of advanced technologies in operations. See McKinsey & Company, How COVID-19 has pushed companies over the technology tipping point—and transformed business forever (October 5, 2020), <https://mck.co/3nlK8b2>.

suspension of the requirement to submit branch office applications on Form BR for new office locations provided in Notice 20-08 (“Form BR Relief”). The baseline includes the scheduled expiration of Rule 3110.17 on the effective date of the proposed Rule 3110.18; and, in order to provide a full accounting of the likely effects of the proposed rule change, the analysis also assumes that, going forward, the temporary suspension of the above requirement is no longer in effect. FINRA expects that numerous additional office locations would then need to be registered, greatly expanding the number of inspections, and all inspections would then need to be conducted on-site.

As of December 31, 2022, FINRA’s membership included 3,381 firms with 150,495 registered branch offices.¹⁰⁶ Of these branch offices, 18,564 (12%) are OSJs subject to an annual inspection requirement. The remaining 131,931 branch locations are non-OSJ branch offices subject to an inspection requirement at least annually or every three years. In addition, according to FINRA estimates, there are approximately 59,830 non-branch locations, of which 41,078 are private residences.¹⁰⁷ A non-branch location must be inspected on a periodic schedule, presumed to be at least every three years. These data may be affected by the temporary relief from certain requirements to update

¹⁰⁶ This count excludes firms with membership pending approval, and withdrawn or terminated from membership.

¹⁰⁷ Non-branch locations do not have to be registered with FINRA. The estimates for non-branch locations, including those that are also private residences, are obtained by reviewing Form U4. There may be some double counting of non-branch locations if members record the address differently on more than one Form U4. For the estimate of non-branch locations, FINRA counted, by firm, unique addresses based on the first seven characters of the Form U4 “Street 1” field, city and state. Addresses that matched the address of the main office or of an existing registered branch were excluded.

Form U4 and to submit Form BR provided in Notice 20-08. FINRA estimates that member firms conduct at least 82,500 inspections per year.

C. Economic Impacts

When the Form BR Relief ends,¹⁰⁸ FINRA expects that numerous additional office locations will need to be registered, greatly expanding the number of inspections, and all inspections would then need to be conducted on site. The economic impacts of these changes would be mitigated by the proposed rule change for firms that choose to participate in the pilot program.¹⁰⁹

The requirements in the Proposed Rule 3110.18 would exclude some member firms entirely or partially by excluding some of their offices or locations from participating in the Remote Inspections Pilot Program. The proposed additional requirements reference events or activities of a member firm or its associated person where remote inspection may result in an increased risk to investors.

¹⁰⁸ When appropriate, FINRA will announce a termination date for the regulatory relief set forth in Notice 20-08 that will provide members with time to make necessary operational adjustments. See generally FINRA’s Key Topic: COVID-19/Coronavirus (referencing, among other things, Frequency Asked Questions Related to Regulatory Relief Due to the Coronavirus Pandemic), <https://www.finra.org/rules-guidance/key-topics/covid-19/faq>.

¹⁰⁹ Separately, FINRA filed a proposed rule change to establish a Residential Supervisory Location (“RSL”), a new non-branch location, that would, relative to the baseline, reduce the number of inspections that members with RSLs would need to conduct in a year. See Securities Exchange Act Release No. 97237 (March 31, 2023), 88 FR 20568 (April 6, 2023) (Notice of Filing of File No. SR-FINRA-2023-006) (“2023 RSL Rule Filing”). For member firms with locations that would meet the proposed definition of an RSL, the aggregate cost savings from choosing to participate in the proposed pilot program would be lower if the RSL proposal were in place because the cost savings from remote inspections would accrue over fewer inspections. The qualitative impacts of the proposed pilot program, however, are similar whether the proposed definition of an RSL is adopted or not.

Using CRD data as of early November 2022, FINRA estimates that under the firm level exclusions from the Initial Proposal, at least approximately 128 firms with 474 registered branches would not qualify for the proposed pilot program. Under the office or location level exclusions, an additional 868 registered branch offices belonging to 278 other firms would be excluded. Thus, a total of approximately 1,342 (= 474+868) registered branch offices would be excluded from the proposed pilot program.¹¹⁰ Based on these figures, FINRA anticipates that at most approximately 2,884 small firms, 183 mid-size firms and 166 large firms could potentially participate in the proposed pilot program and that most large firms would have some branch offices excluded.

Participants in the pilot program would be expected to take a risk-based approach to conducting remote inspections. A firm that does not conduct a remote inspection for an office or location must conduct an on-site inspection of that office or location on the required cycle and remains subject to the other requirements of Rule 3110(c). A firm that chooses to participate in the pilot program (assuming that it is not otherwise ineligible from participating) would also be required to provide FINRA with certain data and other information about the risk-based approach that they implement, the type and frequency of inspections, and certain outcomes conditional on the type and frequency of inspections.

¹¹⁰ Approximately 1,766 firms have a single registered branch office and ten or fewer registered representatives or no registered branch offices. FINRA anticipates that such firms would be less likely to elect to participate in the proposed pilot program. The reason is that it is less likely that these firms would have enough staff working from home such that the benefit of conducting remote inspections relative to the cost of sending data to FINRA and meeting the other proposed pilot program requirements would make participation in the proposed pilot program more practical than conducting physical inspections or eliminating remote work.

Anticipated Benefits

The benefit to eligible firms of choosing to participate in the pilot program, in an improved health environment, would result from limiting the increase in travel costs and lost productivity due to time spent during travel and in the on-site inspection. On-site visits have material costs from travel expenses and additional staff time. A system of risk-based on-site and remote inspections will allow firms to more efficiently deploy compliance resources and to use an on-site component only when appropriate.

Firms as well as investors may benefit if remote inspections provide new flexibility in the design of inspection teams. For example, remote inspections may facilitate the development of specialized inspection staff that are deployed over more inspections, for shorter periods of time, in a targeted way. This option may especially benefit diversified member firms with a variety of product offerings. Remote inspections can also facilitate the use of inspections that target a particular area of focus in a member firm's business across all branches of the member firm.

The proposed rule change may also support the competitiveness of the broker-dealer industry for individuals who seek professional positions in compliance.¹¹¹ The

¹¹¹ See note 105, *supra*. See also Jose Maria Barrero, Nicholas Bloom & Steven J. Davis, *Why Working from Home Will Stick* (NBER Working Paper 28731, April 2021), <https://wfhresearch.com/wp-content/uploads/2021/04/w28731-3-May-2021.pdf>, who point to a lasting effect of the pandemic on work arrangements, in particular for those with higher education and earnings; and Alexander Bick, Adam Blandin & Karel Mertens, *Work from Home Before and After the COVID-19 Outbreak*, (Working Paper, October 2022), https://karelmertenscom.files.wordpress.com/2022/11/wfh_oct_15_paper.pdf, who find consistent results, with a higher adoption rate of work from home jobs in Finance and Insurance, relative to other industries, reflected in Figure 10. Both papers, based on different surveys and, in Bick et al, with added results from a model, conclude that around 22% of full workdays will be provided from home in the long run.

expectation of workplace flexibility and remote work by such individuals may lead them away from the broker-dealer industry if other segments of financial services or professional occupations offer more flexible workforce arrangements, with regulatory frameworks that offer more discretion in how the supervision is conducted.¹¹² Even prior to the pandemic, the scope of on-site inspections had been much reduced due to technological surveillance solutions and centralization of books and records. The proposed pilot would support continued adoption and innovation in technological solutions and reductions in the cost of these solutions.¹¹³

Participants in the proposed pilot program would provide FINRA with quarterly data on the frequency and type of inspections (on-site or remote), counts of findings from inspections subdivided by category of office or location, qualitative information about these findings, and certain information about the written supervisory procedures for remote inspections they are required to have.¹¹⁴ Depending on the number and types of firms that participate in the proposed pilot program, this data may allow FINRA to identify differences in risks between remote versus on-site inspection, both conditional on

¹¹² For example, Advisers Act Rule 206(4)-7 does not require Registered Investment Advisers to conduct in-person inspections or reviews of its offices or personnel.

¹¹³ See Ben Charoenwong, Zachary T. Kowaleski, Alan Kwan & Andrew Sutherland, RegTech (MIT Sloan Research Paper 6563-22, September 16, 2022), <http://dx.doi.org/10.2139/ssrn.4000016>. The authors show that broker-dealers that made compliance technology investments in response to the 2014 amendment of Exchange Act Rule 17a-5 were able to make complementary technology investments in communications and customer relationship management software. These resulted in a reduced number of complaints and less employee misconduct.

¹¹⁴ In addition, if the effective date of the rule is such that the first year of the pilot program covers a period less than a full calendar year, participating firms would be required to provide, the data and information specified in proposed Rule 3110.18(h)(2).

the observable characteristics and policies of firms and overall, the extent of variation in these risks across firms and firm characteristics, and factors associated with very high or low risks.¹¹⁵ The proposed pilot program has the potential to yield a more thorough collection of sensitive information in a structured manner than voluntary submissions or a survey of FINRA members could provide. This data will be useful both for monitoring for risks as the pilot proceeds and, with sufficient participation, for developing a balanced assessment of the potential impact of permitting further remote inspection.

Anticipated Costs

Participation in the proposed pilot program is voluntary, and the proposed rule change provides firms with an additional method for complying with certain supervisory requirements without removing other methods of compliance. Eligible pilot program participants will therefore participate in the pilot program only if doing so is beneficial to their operations relative to complying with current Rule 3110. The cost of complying with the requirements of the proposed pilot program is a factor in this decision. These costs include conducting risk-based analyses for inspections and providing aggregated data on findings to FINRA. The data request in particular may require more standardization and aggregation of inspection findings than some member firms typically conduct. The data request may also not use the same terms or formats used by compliance officers for reporting and tracking inspection findings. Firms may need to develop new written supervisory procedures and new trainings for compliance staff to ensure that all required data is accurate and compiled and submitted to FINRA in a timely

¹¹⁵ In addition, analysis of trends over time will need to consider changes in the macroeconomic environment.

manner. Firms will incur new ongoing costs both for compliance and monitoring for compliance.

Supervision and inspections are intended to identify not only the activities that violate member procedures or FINRA rules but also poor practices that might ultimately allow for such violations. FINRA recognizes that remote inspections may be less likely to identify such practices or activities as on-site inspections. FINRA believes that risks to member firms and investors from remote inspections are mitigated by the proposed requirements to have written supervisory procedures for remote inspections, the proposed requirement to conduct and document risk assessments, the proposed limitations on the firms and locations that would be eligible to participate in the proposed pilot program, and the technology already employed for day-to-day supervision. In addition, FINRA will continue to closely monitor the outcomes of examinations during the pilot program period.

D. Alternatives Considered

The proposed pilot program would continue for three years. FINRA staff considered alternative durations for the program. FINRA members firms vary by business model and organizational structure, so a shorter program is less likely to yield enough data on inspection findings to allow for meaningful comparisons between on-site and remote inspection regimes across members. In addition, inspections are typically planned by members well ahead of time, so some members may not implement the requirements of the program until well into the duration of the pilot program. It may also help firms and the policy development process if FINRA had enough data to meaningfully evaluate well ahead of the expiration of the pilot program.

As discussed above, the requirements in proposed Rule 3110.18 would exclude some member firms entirely or partially by excluding some of their offices or locations from participating in the proposed pilot program. FINRA considered alternative pilot programs with fewer such exclusions. Firms that are entirely or partially excluded that would otherwise participate in the proposed pilot program do not incur a cost relative to the baseline, but they fail to receive the benefits of alternative programs in which they would choose to participate. Restrictions that exclude these firms not only limit the benefits of the pilot program but also limit the potential learnings from the proposed program. As a result, the same restrictions may ultimately need to be carried over into any ongoing program of risk-based examinations. The exclusion of such firms, however, should reduce any risk of customer harm from not having on-site inspections.¹¹⁶

In addition, FINRA considered the merits of adapting other requirements similar to those FINRA has proposed in the 2023 RSL Rule Filing.¹¹⁷ In particular, the 2023 RSL Rule Filing is proposing to impose limitations on the offices or locations that may be designated as an RSL. One limitation is that an office or location at which an associated person has less than one year of supervisory experience with the firm or is functioning as a principal for a limited period in accordance with Rule 1210.04

¹¹⁶ See Zachary T. Kowaleski, Andrew G. Sutherland & Felix W. Vetter, Supervisor Influence on Employee Financial Misconduct (Working Paper, July 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3646617. This paper presents evidence that could be interpreted as supportive of the exclusions based on misconduct and lack of experience.

¹¹⁷ See note 109, *supra*. FINRA previously filed a similar proposed rule change with the SEC to adopt proposed Rule 3110.19, which FINRA withdrew on March 29, 2022. See <https://www.finra.org/sites/default/files/2023-03/sr-finra-2022-019-withdrawal.pdf>.

(Requirements for Registered Persons Functioning as Principals for a Limited Period) would be ineligible for RSL designation. FINRA believes that adding these limitations to this proposed rule change would not be appropriate because the presence of even one such associated person at an office or location would disqualify an office or location of any size from participating in the proposed pilot program. FINRA believes that imposing these limitations in this proposed rule change would adversely impact the potential population of pilot program participants, which would then negatively impact FINRA's data and information collection efforts to gauge the effectiveness of remote inspections in a hybrid work environment. Moreover, FINRA believes that this proposed rule change provides for the appropriate controls for participation in the proposed pilot program.

Finally, FINRA considered different levels of detail for the data reporting requirement. FINRA has tried to carefully balance the reporting burden for firms with the need for enough information to make statistically valid comparisons. Nevertheless, depending on the number and type of pilot program participants, interpretation of the results will be subject to caveats.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The SEC published the 2022 Remote Inspections Pilot Program Rule Filing for comment and as of the end of the comment period on September 6, 2022, the SEC had received 24 comment letters, then subsequently received four more new comment letters.¹¹⁸ On November 10, 2022, the Commission instituted proceedings to determine whether to approve or disapprove the 2022 Remote Inspections Pilot Program Rule Filing

¹¹⁸ See note 51, supra.

(“Order”), and the SEC received five comments letters in response to the Order.¹¹⁹ On December 15, 2022, FINRA filed Partial Amendment No. 1 and responded to the comment letters.¹²⁰ On December 22, 2022, the SEC published the partial amendment to the 2022 Remote Inspections Pilot Program Rule Filing for comment and as of the end of the comment period on January 12, 2023, the SEC had received four comment letters.¹²¹ On April 11, 2023, FINRA withdrew the 2022 Remote Inspections Pilot Program Rule Filing to consider whether more safeguards and clarifications to the filing would be appropriate in response to concerns raised by commenters. While the proposed rule change retains many of the terms set forth in the 2022 Remote Inspections Pilot Program Rule Filing, the proposed rule change makes some adjustments, which are discussed in detail above under Item 3.(a)IV.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.¹²²

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

¹¹⁹ See Securities Exchange Act Release No. 96297 (November 10, 2022), 87 FR 68774 (November 16, 2022) (Order Instituting Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2022-021).

¹²⁰ See Exhibits 2b and 2c.

¹²¹ See note 51, *supra*.

¹²² 15 U.S.C 78s(b)(2).

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 2a. A copy of the 2022 Remote Inspections Pilot Program Rule Filing's Form 19b-4.

Exhibit 2b. A copy of FINRA's Partial Amendment No. 1 to the 2022 Remote Inspections Pilot Program Rule Filing.

Exhibit 2c. A copy of FINRA's Response to Comments.

Exhibit 2d. A copy of FINRA's Withdrawal of the 2022 Remote Inspections Pilot Program Rule Filing.

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2023-007)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA Rule 3110 (Supervision) to adopt a voluntary, three-year remote inspections pilot program to allow member firms to elect to fulfill their obligation under paragraph (1) to Rule 3110(c) (Internal Inspections) by conducting inspections of some or all branch offices and locations remotely without an on-site visit to such office or location, subject to specified terms. As detailed below, the key terms would include, among others: (1) a requirement for a firm to conduct and document a risk assessment for inspecting an office or location remotely and providing a

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

non-exhaustive list of factors to consider for this risk assessment; (2) criteria that would make a member firm ineligible to participate in the program; (3) conditions a member firm must satisfy before becoming a pilot program participant relating to the firm's recordkeeping system, and surveillance and technology tools; (4) criteria that would make ineligible for remote inspection certain member firm offices or locations; (5) conditions a member firm's office or location must satisfy to be able to undergo a remote inspection relating to electronic communications, correspondence, and books and records; (6) a requirement that a participating firm provide FINRA specified data and information on a quarterly basis; and (7) authorization for FINRA to determine in the public interest that a firm is no longer eligible to participate in the proposed program.

The proposed Remote Inspections Pilot Program would not change the current requirements under Rule 3110(c). Instead, the proposed program would provide firms the flexibility to satisfy their Rule 3110(c)(1) inspection obligation with or without an on-site visit to the office or location, subject to the proposed terms described herein. FINRA believes that proposed Rule 3110.18, on balance, preserves investor protection objectives through the proposed safeguards while also providing FINRA the opportunity to gauge the effectiveness of remote inspections as part of a modernized, reasonably designed supervisory system that reflects the current work environment and availability of technologies that did not exist when the on-site inspection originally was conceived.

Subject to further clarifications to proposed Rule 3110.18 as described below, the terms of the proposed rule change herein are largely similar to File No. SR-FINRA-2022-

021 filed in July 2022,³ then amended in December 2022⁴ (together, the “2022 Remote Inspections Pilot Program Rule Filing”). FINRA withdrew File No. SR-FINRA-2022-021 on April 11, 2023 to consider whether more safeguards and clarifications to the filing would be appropriate in response to concerns raised by commenters.⁵ This proposed rule change is organized in five sections: (1) the background, which provides a historical overview of Rule 3110(c), and discusses the environmental changes that have occurred over the years relating to technology and the workplace; (2) FINRA’s observations of evolving inspection practices; (3) the emergence of remote inspections as a new approach to evaluation under Rule 3110(c)(1); (4) a description of the terms of the proposed rule change; and (5) an overview of FINRA’s monitoring and compliance with proposed Rule 3110.18.

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it

³ See Securities Exchange Act Release No. 95452 (August 9, 2022), 87 FR 50144 (August 15, 2022) (Notice of Filing of File No. SR-FINRA-2022-021) (“Initial Rule Filing”); see also Exhibit 2a.

⁴ See Securities Exchange Act Release No. 96520 (December 16, 2022), 87 FR 78737 (December 22, 2022) (Notice of Partial Amendment No. 1 to File No. SR-FINRA-2022-021) (“Amended Rule Filing”); see also Exhibit 2b.

⁵ See Exhibit 2d.

received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

(I) Background

A. Overview

The responsibility of firms to supervise their associated persons is a critical component of broker-dealer regulation.⁶ Member firms must supervise all of their associated persons, regardless of their location, compensation or employment arrangement, or registration status.⁷ Rule 3110 requires a member, regardless of size or

⁶ See generally SEC Division of Market Regulation, Staff Legal Bulletin No. 17: Remote Office Supervision (March 19, 2004) ("SLB 17") (SEC guidance on remote office supervision), <https://www.sec.gov/interps/legal/mrslb17.htm>; and Regulatory Notice 11-54 (November 2011) ("Notice 11-54") (joint SEC and FINRA guidance on effective policies and procedures for broker-dealer branch inspections).

⁷ This obligation is consonant with Sections 15(b)(4)(E) and 15(b)(6)(A) of the Exchange Act. Section 15(b)(4)(E) provides that the:

Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer if it finds . . . that such broker or dealer . . . or any person associated with such broker or dealer . . . has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any person of any provision of the Securities Act of 1933, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, [the Securities Exchange Act of 1934], the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, or has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another

type, to have a supervisory system for the activities of its associated persons that is reasonably designed to achieve compliance with the applicable securities laws and regulations and FINRA rules, and sets forth the minimum requirements for such supervisory system.⁸ The internal inspection obligation under Rule 3110(c) is one component of such system.

Before the adoption of Rule 3110(c) in its current form as described below, FINRA's (then NASD's) Rules of Fair Practice⁹ required a member firm to review the activities of each office including the periodic examination of customer accounts to detect and prevent irregularities and abuses and at least an annual inspection of each OSJ.¹⁰ Subsequently, FINRA expanded the review requirement to include not only the activities of each office, but also the businesses in which a member firm engages.¹¹

person who commits such a violation, if such other person is subject to his supervision. 15 U.S.C. 78o(b)(4)(E).

Section 15(b)(6)(A)(i) parallels Section 15(b)(4)(E) and provides for the imposition of sanctions against persons associated with a broker or dealer that violates those statutes, rules and regulations enumerated in Section 15(b)(4)(E) and other specified subparagraphs under Section 15(b)(4). 15 U.S.C. 78o(b)(6)(A).

⁸ See Rule 3110(a).

⁹ Then NASD adopted its Rules of Fair Practice when it was founded in 1939 under provisions of the 1938 Maloney Act amendments to the Exchange Act.

¹⁰ See Notice to Members 87-41 (June 1987) ("Notice 87-41") (setting forth the proposed rule text changes to Article III, Section 27 of the NASD Rules of Fair Practice for the review and annual inspection requirement, among other provisions).

¹¹ See Notice to Members 88-84 (November 1988) ("Notice 88-84").

The expanded review requirement included, among other things, an inspection of branch offices in accordance with a schedule as set forth in the member's supervisory procedures.¹² This expansion was intended to address concerns about the adequacy of ongoing supervision and regular examination of associated persons engaged in the offer and sale of securities to the public at locations away from a member firm's office.¹³ FINRA guidance during this period of supervisory change focused on the need for the effective supervision of the securities-related activities of "off-site representatives," and advised firms of the importance of not only reviewing their supervisory systems and procedures to ensure that they were current and adequate, but also conducting inspections to determine whether these systems and procedures were being followed.¹⁴ Further, the guidance advised firms that an inspection should include, among other things, a "review of any on-site customer account documentation and other books and records, meetings with individual registered representatives to discuss the products they are selling and their sales methods, and an examination of correspondence and sales literature."¹⁵

The guidance about the effective supervision of "off-site representatives" and what an inspection entailed was pragmatic at a time when business activities were

¹² See Notice 88-84. By 2004, the requirement to inspect a branch office in accordance with a regular schedule as set forth in the member's supervisory procedures was replaced by mandatory inspection cycles as set forth under Rule 3110(c)(1). See Notice to Members 04-71 (October 2004).

¹³ See Notice 88-84.

¹⁴ See Notice to Members 99-45 (June 1999) ("Notice 99-45").

¹⁵ See Notice to Members 98-38 (May 1998) ("Notice 98-38") and Notice 99-45; see also Notice to Members 86-65 (September 1986) ("Notice 86-65").

conducted primarily using paper documents¹⁶ that were created and stored locally at an office or location; registered persons were interacting with their customers largely through in-person meetings, paper-based correspondence transmitted through the postal service, and landline telephone calls; and supervisory personnel were conducting supervision through manual reviews of paper files (e.g., exception reports bearing a supervisor's handwritten comments and initials or signature). In that environment, the best practice to determine whether the firm's supervisory system and procedures were being followed was through having firm compliance personnel visit the office or location. This practice has remained the prevailing means to satisfy the inspection obligation under Rule 3110(c)(1).

Currently, Rule 3110(c) sets forth three main requirements for inspections. First, an inspection of an office or location must occur on a designated frequency. The periodicity of the required inspection varies depending on the classification of the location or the nature of the activities that take place: OSJs and supervisory branch offices must be inspected at least annually;¹⁷ non-supervisory branch offices, at least every three years;¹⁸ and non-branch locations, on a periodic schedule, presumed to be at least every three years.¹⁹ Second, a member must retain a written record of the date upon

¹⁶ Paper-based documents included, for example, customer account opening documents; correspondence with customers; marketing materials; communications from registered persons to the firm; order tickets; checks received and forwarded; and fund transmittal records.

¹⁷ See Rule 3110(c)(1)(A).

¹⁸ See Rule 3110(c)(1)(B).

¹⁹ See Rules 3110(c)(1)(C) and 3110.13 (General Presumption of Three-Year Limit for Periodic Inspection Schedules).

which each review and inspection occurred, reduce a location's inspection to a written report and keep each inspection report on file either for a minimum of three years or, if the location's inspection schedule is longer than three years, until the next inspection report has been written.²⁰ If applicable to the location being inspected, the inspection report must include the testing and verification of the member's policies and procedures, including supervisory policies and procedures, in specified areas.²¹ Third, to prevent compromising the effectiveness of inspections due to conflicts of interest, the rule requires a member to ensure that the person conducting the inspection is not an associated person assigned to the location or is not directly or indirectly supervised by, or otherwise reporting to, an associated person assigned to that location.²² All branch offices and non-branch locations are subject to Rule 3110(c).

²⁰ See Rule 3110(c)(2).

²¹ See Rule 3110(c)(2)(A) (providing that the inspection report must include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures for: (1) safeguarding of customer funds and securities; (2) maintaining books and records; (3) supervision of supervisory personnel; (4) transmittals of funds from customers to third party accounts, from customer accounts to outside entities, from customer accounts to locations other than a customer's primary residence, and between customers and registered representatives, including the hand delivery of checks; and (5) changes of customer account information, including address and investment objectives changes, and validation of such changes).

²² Rule 3110(c)(3) provides a limited exception from this requirement if a firm determines compliance is not possible either because of the firm's size or its business model. Rule 3110.14 (Exception to Persons Prohibited from Conducting Inspections) reflects FINRA's expectation that a firm generally will rely on the exception in instances where the firm has only one office or has a business model where small or single-person offices report directly to an OSJ manager who is also considered the offices' branch office manager. However, these situations are non-exclusive, and a firm may still rely on the exception in other instances where it cannot comply because of its size or business model, provided the firm complies with the documentation requirements under the rule.

Further, Rule 3110.12 (Standards for Reasonable Review) sets out factors that constitute a reasonable review. This provision emphasizes establishing reasonable supervisory procedures and conducting reviews of locations, taking into consideration, among other things, the member's size, organizational structure, scope of business activities, number and location of the member's offices, the nature and complexity of the products and services offered by the member, the volume of business done, the number of associated persons assigned to a location, the disciplinary history of registered representatives or associated persons, and any indicators of irregularities or misconduct (i.e., "red flags").²³ The provision further states that the procedures established and reviews conducted must provide that the quality of supervision at remote (i.e., geographically dispersed) locations is sufficient to ensure compliance with applicable securities laws and regulations and with FINRA rules, and that members must be especially diligent with respect to a non-branch location where a registered representative engages in securities activities. This provision incorporates guidance FINRA has

²³ Such red flags may include: customer complaints; a large number of elderly customers; a concentration in highly illiquid or risky investments; an unexplained increase or change in the types of investments or trading concentration that a representative is recommending or trading; an unexpected improvement in a representative's production, lifestyle, or wealth; questionable or frequent transfers of cash or securities between customer or third party accounts, or to or from the representative; a representative that serves as a power of attorney, trustee or in a similar capacity for a customer or has discretionary control over a customer's account(s); a representative with disciplinary records; customer investments in one or a few securities or class of securities that is inconsistent with firm policies related to such investments; churning; trading that is inconsistent with customer objectives; numerous trade corrections, extensions, liquidations; or significant switching activity of mutual funds or variable products held for short time periods. See SLB 17, supra note 6; see also Notices 98-38 and 99-45.

previously issued about supervising associated persons working in geographically dispersed offices.²⁴

In 2004, the SEC staff similarly provided guidance to broker-dealers on supervision principles.²⁵ At that time, the SEC staff noted that small, geographically scattered offices presented supervisory challenges when they were not subject to on-site supervision. The SEC staff observed that an office’s geographic distance from supervisory personnel could make it easier for registered persons and other employees to carry out and conceal violative conduct. This general observation was derived from SEC enforcement cases finding that firms had inadequately supervised their associated persons working in small, geographically distant offices due to the failure of their supervisory mechanisms to detect and prevent misconduct. Citing technology available at the time, the guidance emphasized that an effective supervisory system for geographically dispersed offices uses a combination of on-site and off-site monitoring; it specifically said that “[c]entralized technology to monitor the trading and handling of funds in remote office accounts, as well as the use of personal computers, helps detect misappropriation of customer funds, selling away, and unauthorized trading, among other things[.]”²⁶ The guidance supported both routine or “for cause” on-site inspections, and encouraged unannounced inspections either on a random basis or where there are red flags about unusual activity at those offices. Further, SEC staff and FINRA issued joint guidance that included a FINRA interpretation of Rule 3110(c)(1) requiring member firms to

²⁴ See, e.g., Notices 98-38 and 99-45.

²⁵ See SLB 17, supra note 6.

²⁶ See SLB 17, supra note 6.

conduct on-site inspections of branch offices and unregistered offices (i.e., non-branch locations) and stating that the inspection process is an element of a firm’s compliance and reasonable supervision of its offices and locations, and personnel, and a component of a firm’s risk management program.²⁷ In the joint guidance, the SEC and FINRA also articulated that the “inspection provides the firm with the opportunity to validate its surveillance results from branch offices and to gather on-site intelligence that supplements the ongoing management and surveillance of the branch from a business and risk management standpoint.”²⁸ Since the time these in-person guidelines were expressed, workplace models have changed significantly and developments in technology have enhanced firms’ overall and ongoing supervision and monitoring of the activities occurring at branch offices and non-branch locations. In response to these developments, member firms have questioned the historical expectation that firms satisfy the inspection component of Rule 3110(c) in a physical, on-site manner.

B. Environmental Changes Support Revision of In-Person Supervisory Conventions Relating to Rule 3110(c)(1)

Over the years, widespread advancements in technology and communications in the financial industry have significantly changed the way in which members and their

²⁷ See Notice 11-54 (stating, in part, a “broker-dealer must conduct on-site inspections of each of its office locations; [OSJs] and non-OSJ branches that supervise non-branch locations at least annually, all non-supervising branch offices at least every three years; and non-branch offices periodically.”). See also SLB 17 (stating, in part, that broker-dealers that conduct business through geographically dispersed offices have not adequately discharged their supervisory obligations where there are no on-site routine or “for cause” inspections of those offices), <https://www.sec.gov/interps/legal/mrslb17.htm>.

²⁸ See Notice 11-54.

associated persons conduct their business and communicate, including the practices that formed the original bases for the on-site inspection. For example, making and preserving records electronically have increasingly become the norm and the preferred recordkeeping medium rather than paper (e.g., cloud based storage); communications between and among members, their associated persons and customers commonly take place through email, video or online meeting programs (e.g., WebEx, Zoom) that can be monitored electronically by firms;²⁹ processes for opening customer accounts and placing trades are moving to online platforms; and customer funds and securities are frequently and increasingly transmitted electronically rather than in physical form (e.g., Venmo, Zelle). Relatedly, the challenges in supervising associated persons who work in outlying offices or locations (i.e., “off-site representative”) have been mitigated over the years with the prevalent and effective use of technology. For example, supervisory reviews for outside business activities of registered persons are often conducted through general internet searches, including social media and online public records, and by reviewing electronic communications and customer fund transfers. Similarly, reviews of

²⁹ Many customers now expect their primary mode of interaction with their firm to be digital. In a study to learn about investors who, during year 2020, entered into the markets using taxable, non-retirement investment accounts, FINRA found that nearly half (48%) of “new investors,” investors who opened a non-retirement investment account during 2020, indicated that they accessed their account primarily through a mobile app, and three-quarters (75%) of “holdover account owners,” investors who maintained a taxable investment account opened before year 2020, indicated they accessed their account primarily through a website. See generally FINRA Investor Education Foundation & NORC, Consumer Insights: Money & Investing, Investing 2020: New Accounts and the People Who Opened Them at 11 (February 2021), https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf.

correspondence, customer funds and securities, and order flows are accomplished primarily through the use of electronic tracking programs or applications.

In addition, the progressive digitization of firm data and the centralization of control functions have converged, with significant advantages for a firm's supervision of its business, including monitoring of an associated person's activities and conducting inspections. Today, many firms capture the lifecycle of an associated person's activities with a firm, as well as a customer's interactions with the firm, in digital audit trails. Such activities include, for example, information about associated persons and customers obtained at the account opening process; communications between associated persons and customers or among associated persons; order and trade activity; and money and security movements in customer accounts. As a result, a firm can monitor the activities of its associated persons and customers continuously, on a real-time or near-real time basis, and react promptly to actual or potential exceptions to routine behaviors, rather than depend on a "point-in-time" office inspection visit on a prescribed schedule.

Further, increased digitization has centralized elements of firm compliance and supervisory functions, and these centralized functions have become the front line in supervision and surveillance. Rather than having a firm's compliance personnel walk around an office or location during an inspection to identify potential problems or to gather on-site intelligence—an approach that relies on chance encounters such as overhearing an associated person making a sales pitch to a customer for a product a firm is not approved to sell or observing an associated person cutting and pasting a customer signature onto a form—digitization now allows a firm to readily "walk around the data," reducing the member's dependence on on-site intelligence because most of activities

occurring at an office or location are electronically captured. The technology-driven environment has provided firms the opportunity to develop a more holistic view of a firm's risk management programs, fostering a more efficient and timely response to areas of concern. For example, centralized control functions strengthen supervision by enabling a firm to implement more frequent or ongoing, repeatable, consistent, and highly scalable approaches to analyzing the activities of associated persons across dispersed offices and locations, creating a level of process discipline not previously achievable in the past. These centralized control functions allow a firm to identify potential areas of concern, and implement targeted solutions or preventative measures in a more timely manner. For example, a fraud specialist team may identify a new fraud scenario and then promptly implement a new surveillance pattern to identify red flags for this behavior throughout the firm. A firm may also use in-house or vendor-created technologies to regularly adjust and "right size" its surveillance alerts and patterns. For example, a firm may quickly adjust its email review lexicons to surveil communications relating to any topic or term.

FINRA notes that firms are turning to new and innovative regulatory tools such as artificial intelligence, natural language processing, and robotics process automation, among others, to strengthen their compliance programs.³⁰ Over the last few years, firms have questioned the benefits and practicalities of the need to conduct an inspection in an on-site manner for each office and location, particularly in light of these significant technological advances that have not only changed the way in which firms conduct

³⁰ See generally FINRA White Paper, Technology Based Innovations for Regulatory Compliance ("RegTech") in the Securities Industry (September 2018), https://www.finra.org/sites/default/files/2018_RegTech_Report.pdf.

business and communicate, but also enhanced the effectiveness and efficiencies of a firm's overall and ongoing supervision and monitoring of the activities occurring at their offices and locations.³¹

C. Impact of the Pandemic on Workplace Arrangements, and Diversity, Equity and Inclusion

The COVID-19 pandemic, identified in early 2020,³² has had a profound and lasting impact on workplace arrangements, and brought focus to the integrity of firms' supervisory systems in a more dispersed work environment. The pandemic accelerated the use of a wide variety of compliance and workplace technology as many government and private employers, including member firms, were driven to adopt a broad remote work environment by quickly moving their employees out of their usual office setting to an alternative worksite such as a private residence. Insights obtained from member firms and other industry representatives through various pandemic-related initiatives and other industry outreach have led FINRA to carefully consider whether some processes and rules, including the manner in which a firm may satisfy its Rule 3110(c)(1) obligations,

³¹ Some firms have indicated, for example, that technology has enhanced real time monitoring of their associated persons by providing the ability for firm compliance personnel to join, on an ad hoc basis, digital or virtual meetings occurring between the firm's associated persons and customers. Firms have also indicated that technology has allowed them to impose various restrictions or limitations on associated persons, such as the ability to print firm records from remote locations using a firm-issued laptop, and only accepting electronic payments from customers.

³² See Centers for Disease Control and Prevention ("CDC"), International Classification of Diseases, Tenth Revision, Clinical Modification (ICD-10-CM) (Effective March 18, 2020), <https://www.cdc.gov/nchs/data/icd/Announcement-New-ICD-code-for-coronavirus-3-18-2020.pdf>. See also WHO Director-General's Opening Remarks at the Media Briefing on COVID-19 (March 11, 2020), <https://www.who.int/director-general/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020>.

should be modernized.³³ Technological improvements and developments in regulatory compliance have provided more tools than before to create more effective and efficient compliance programs. To that end, FINRA believes that regulatory models should evolve to benefit from the availability and use of effective technology tools. The SEC’s recent Strategic Plan similarly recognized that “[t]echnology and business models are always changing, and it is important for [the SEC] to evolve in kind[,]” and expressed the overall need to “[u]pdate existing SEC rules and approaches to reflect evolving technologies, business models, and capital markets.”³⁴ With the confluence of advances in compliance technology and the shift to hybrid work environments, FINRA believes that the optimal use of on-site inspections deserves further consideration as part of the overall effort to modernize FINRA rules to reflect evolving technologies and business

³³ See generally FINRA’s Key Topic: COVID-19/Coronavirus (referencing, among other things, Frequency Asked Questions, temporary amendments to FINRA rules, and Regulatory Notices such as Regulatory Notices 20-08 (March 2020) (“Notice 20-08”), regarding pandemic-related business continuity planning, guidance and regulatory relief to member firms from some requirements, including the temporary suspension of the requirement to maintain updated information on Form U4 (Uniform Application for Securities Industry Registration or Transfer) and submit Form BR (Uniform Branch Office Registration Form) for temporary locations; 20-16 (May 2020) (“Notice 20-16”), describing practices implemented by firms to transition to, and supervise in, remote work environment during the COVID-19 pandemic; 20-42 (December 2020) (“Notice 20-42”), seeking comment on lessons from the pandemic; and 21-44 (December 2021), regarding business continuity planning and lessons from the pandemic, <https://www.finra.org/rules-guidance/key-topics/covid-19>). See also SEC Press Release 2022-112 (June 22, 2022) for the Spring 2022 Regulatory Agenda (quoting SEC Chair Gary Gensler: “When I think about the SEC’s agenda, I’m driven by two public policy goals: continuing to drive efficiency in our capital markets and modernizing our rules for today’s economy and technologies.”), https://www.sec.gov/news/press-release/2022-112?utm_medium=email&utm_source=govdelivery.

³⁴ See SEC, Strategic Plan for fiscal years 2022 to 2026 (November 23, 2022), https://www.sec.gov/files/sec_strategic_plan_fy22-fy26.pdf.

models.³⁵ As such, FINRA believes it is appropriate now to assess possible longer-term rule changes and is, therefore, proposing a voluntary, three-year remote inspections pilot program. This program would provide FINRA with specific, structured data from pilot program participants to evaluate impacts—positive and negative—on inspection findings and to systematically assess the overall impact on firms’ supervisory systems, which has not been feasible with information drawn from the pandemic-related office shutdowns. Moreover, the proposed pilot program would maintain effective supervision by firms through the ongoing supervisory obligations under Rule 3110, and the proposed limitations on the firms and locations that would be eligible to participate in the proposed pilot program. FINRA emphasizes that the proposed pilot program is not intended to signal the abandonment of on-site inspections, but to assess the effectiveness and efficiency of additional approaches, subject to specified controls, for firms to meet their inspection obligations under Rule 3110(c)(1) while still preserving the investor protection objectives of the rule.

Firms have also conveyed that the flexibility of hybrid work has made a positive impact in attracting more diverse talent and retaining existing talent. These views are

³⁵ FINRA notes one state regulator has issued a policy statement, acknowledging that “more businesses have adapted practices, hired employees, and instituted other changes to their compliance initiatives which have allowed them to adapt to working from a remote setting.” As a result, the state securities commissioner concluded that a “full and thorough Branch Inspection conducted remotely may allow broker-dealers similar opportunity to monitor practices and ensure regulatory compliance when compared with in-person Branch Inspections.” Through this policy statement, a broker-dealer registered in the state may satisfy that state’s branch office examination requirements through remote inspections by using mediums such as video conference and digital file sharing. See Indiana Secretary of State Securities Division, Statement of Policy Regarding Broker-Dealer Branch Office Examinations in 2023 (January 13, 2023), <https://securities.sos.in.gov/sop-bd-branch-exams-2023>

consistent with those expressed by several commenters in response to the Initial Rule Filing.³⁶ For example, several commenters to the Initial Rule Filing noted the positive impact that proposal was expected to have on workplace flexibility and hiring efforts that would enhance talent recruitment and retention in the financial industry, particularly with respect to diversity and inclusion initiatives.³⁷ In general, the U.S. workforce has increasingly demanded greater workplace flexibility and the securities industry is subject to the same national pressures as it aims to recruit and retain diverse, talented and qualified employees, especially supervisors essential to a reasonably designed supervisory program.³⁸ Notably, the SEC has also indicated that it needed to “harness the benefits of telework as highlighted during the pandemic[.]”³⁹

(II) FINRA’s Observations of Evolving Inspection Practices

Over the last decade, FINRA has observed that the widespread advances in technology in the financial industry, including the progressive digitization of data and the centralization of control functions, have given firms the greater ability to continuously monitor for, identify and investigate atypical behaviors or patterns. With this evolution, the importance of on-site inspections as a primary means to identify non-compliant

³⁶ See Exhibit 2c.

³⁷ See Exhibit 2c.

³⁸ See, e.g., McKinsey & Company, Americans are embracing flexible work—and they want more of it (June 23, 2022) (highlighting survey results that 58 percent of U.S. workers, an estimated 92 million people, shared that they can work remotely at least part of the time, and that when employees are given the option to work remotely, 87 percent of employees chose to do so), https://www.mckinsey.com/industries/real-estate/our-insights/americans-are-embracing-flexible-work-and-they-want-more-of-it#/.

³⁹ See note 34, supra.

conduct at all offices and locations has seemingly diminished. Inspection practices that previously depended on an on-site presence at an office or location included, for example, reviewing paper-based books and records (e.g., logs or blotters reflecting transmittals of funds and securities, and paperwork related to new customer accounts); testing the implementation of controls at the office or location relating to the security of checks and stock certificates, the security of an office or location itself (e.g., secured file cabinets containing paper-based books and records); reviewing how supervisors perform their functions such as ensuring that an associated person's uniform form filings were current and accurate; and looking for physical signs of an associated person's outside business activities that were unreported to the firm or a lifestyle that did not align with the associated person's compensation or production levels.

As firms are working in a progressively more digitized environment and operating under a system of controls that has become more centralized, FINRA has observed that in general, much of the work traditionally associated with an on-site inspection takes place before the on-site visit. For example, efforts to investigate potential undisclosed outside business activities or evidence of a registered person's lifestyle that may not be commensurate with the person's revenue production at the firm are accomplished through general internet searches of social media and public records; and irregular customer account activity, trading activity, and written communications are reviewed through the firm's electronic systems. The pandemic has revealed the pragmatism of satisfying Rule 3110(c)(1) through an on-site process in a technological environment that is vastly different from the environment in which the office review requirement was expanded in the 1980s. In engagement with industry representatives, particularly in recent years,

some firms have shared with FINRA that the variance between their rates of inspection findings through an on-site process and findings through a remote process were not material. These firm observations align with the observations some commenters conveyed in response to the Initial Rule Filing.⁴⁰ Moreover, FINRA’s experience examining firms’ remote inspection programs also aligns with these observations.

In 2022, FINRA examined several firms, including those that operate under an independent contractor business model and others with branch office networks, to test their compliance with Rule 3110.17, the temporary provision that provides firms the option, subject to the specified requirements under that supplementary material, to complete their calendar year inspection obligations remotely without an on-site visit to the office or location.⁴¹ The targeted examinations assessed firms’ implementation of their remote inspection processes and the effectiveness of their supervisory systems. FINRA found that, in general, these systems were effective in supporting remote branch office inspections. Of the examinations completed for Rule 3110.17 compliance, approximately 43% resulted in no findings and 21% identified findings that were operational in nature and did not raise concerns of customer harm, while 36% of the examinations remain ongoing. In addition to engaging in ongoing surveillance of activities, FINRA observed that firms were using, among other inspection tools, “pre-audit” questionnaires to assess the risk level of a branch office and determine the

⁴⁰ See Exhibit 2c.

⁴¹ See Securities Exchange Act Release No. 96241 (November 4, 2022), 87 FR 67969 (November 10, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-030). See also Item II.A.1.(III)B. for further discussion.

frequency of inspections (remote or on-site) on an announced or unannounced basis. In addition, FINRA observed firms making broad use of technology to supervise the activities of their associated persons remotely to: identify undisclosed private securities transactions and outside business activities; identify problematic electronic communications; surveil trades and movements of customer assets; conduct interviews with supervisors and other associated persons assigned to the office or location; take and record online office tours; and review associated persons' computers in real-time using tools such as remote desktop software. FINRA's overall examination findings in recent years across all firm examinations conducted during the period in which firms were conducting fully remote inspections or operating in a fully remote or hybrid work environment, have remained within the bounds of general norms.⁴²

(III) The Emergence of Remote Inspections as a New Approach to Evaluate Under Rule 3110(c)(1)

A. The 2017 Proposal to Allow Remote Inspections and the Impact from the Pandemic

Even prior to the pandemic, in 2017, FINRA considered a proposal to give firms the option of satisfying the inspection requirement remotely for "qualifying offices" that met specified criteria.⁴³ However, the pandemic significantly changed the industry's

⁴² FINRA notes that examination findings that were attributable to complying with a new regulation adopted by the SEC, for example, are separate from this general view.

⁴³ See Regulatory Notice 17-38 (November 2017) ("2017 Proposal"). FINRA requested comment on a proposed amendment to Rule 3110 to allow remote inspections of "qualifying offices" that met specified criteria, in lieu of on-site inspections of such offices and locations. In general, many of the comment letters FINRA received expressed support for the underlying concept of remote inspections and offered recommendations on specific criteria to broaden the potential population of qualifying offices.

standard business operations, forcing member firms to adapt to a full remote work environment and implement remote supervisory practices.⁴⁴ Consequently, FINRA deferred the 2017 Proposal in light of the pressing need to address significant operational disruptions to the securities industry, regulators, impacted member firms, investors and other stakeholders. During this exigent period, FINRA responded to numerous issues and questions that urgently arose.⁴⁵ Following up on these actions, FINRA published Notice 20-42 to gain a broader understanding of member firm experiences during the pandemic. This notice sought feedback from firms about their experiences in a range of areas, including how member firms' operations and business models changed during the public health crisis and how they might further evolve as the pandemic persisted. Other initiatives included sharing general practices of firms in transitioning and supervising in the remote work environment, and providing temporary relief to member firms from specified FINRA rules and requirements. In particular, to give firms an opportunity to better manage their operational challenges and redirect resources attendant to fulfilling their inspection obligations, FINRA provided temporary relief to member firms pertaining to Rule 3110(c).⁴⁶

B. Temporary Amendments to the Inspection Requirement Under Rule 3110(c)

The ensuing pandemic-related operational changes made it impracticable for member firms to conduct the on-site inspection component of Rule 3110(c) at most

⁴⁴ See generally Notice 20-16.

⁴⁵ See note 33, supra.

⁴⁶ See Rules 3110.16 and 3110.17.

offices and locations because of limitations on travel to geographically dispersed OSJs, branch offices, and non-branch locations. In response to the logistical challenges, FINRA extended the time by which member firms were required to complete their calendar year 2020 inspection obligations under Rule 3110(c) to March 31, 2021 with the expectation that the extension did not relieve firms from the on-site portion of the inspections of their offices and locations.⁴⁷ However, health and safety concerns remained unabated and with many restrictive measures still in place as calendar year 2020 was ending, FINRA adopted Rule 3110.17 to provide member firms the option, subject to specified requirements under the supplementary material, to complete remotely their calendar year inspection obligations without an on-site visit to the office or location.⁴⁸ This relief was repeatedly extended and currently, Rule 3110.17 will automatically sunset on December 31, 2023.⁴⁹

Through comments to the 2017 Proposal, Notice 20-42, the various temporary amendments to Rule 3110, and other engagement with industry representatives, firms

⁴⁷ See Securities Exchange Act Release No. 89188 (June 30, 2020), 85 FR 40713 (July 7, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-019).

⁴⁸ See Securities Exchange Act Release No. 90454 (November 18, 2020), 85 FR 75097 (November 24, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-040).

⁴⁹ See Securities Exchange Act Release No. 93002 (September 15, 2021), 86 FR 52508 (September 21, 2021) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2021-023); Securities Exchange Act Release No. 94018 (January 20, 2022), 87 FR 4072 (January 26, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-001); and Securities Exchange Act Release No. 96241 (November 4, 2022), 87 FR 67969 (November 10, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-030).

have highlighted that technological advances, as described above, have allowed a large portion of the inspection work to be conducted electronically, prior to any on-site visit to the office and location, and that in general, inspecting offices and locations in accordance with Rule 3110(c)(1) through a compulsory on-site process is not an efficient and effective use of limited firm resources.⁵⁰

Rule 3110.17 was adopted in the midst of the pandemic, when many offices and locations were forced to close to allow employees to carry on with their responsibilities from alternative worksites. This relief has been extended as pandemic concerns continued.⁵¹ FINRA recognizes that the pandemic has changed the conventional thinking on where work is conducted and this shift in the workforce landscape will unlikely revert to the model that existed pre-pandemic.

⁵⁰ In response to FINRA’s proposed rule changes associated with Rule 3110.17, one commenter made similar points about the physical, on-site piece of the inspection process. This commenter stated that pre-pandemic, an on-site inspection of a branch office typically consisted of reviewing the lobby area of the office, the back office (to review safe contents, sales literature, daily operations logs containing account applications), signage, and the physical security of the office. See Letter from Carrie L. Chelko, Chief Compliance Officer, Fidelity Brokerage Services LLC (“Fidelity Brokerage”) & Norman L. Ashkenas, Chief Compliance Officer, National Financial Services LLC (“NFS”) and Fidelity Distributors Company LLC (“Fidelity Distributors”), to Vanessa Countryman, Secretary, SEC, dated July 28, 2020, in response to File No. SR-FINRA-2020-019, <https://www.sec.gov/comments/sr-finra-2020-019/srfinra2020019-7488701-221389.pdf>, and Letter from Gail Merken, Chief Compliance Officer, Fidelity Brokerage, Janet Dyer, Chief Compliance Officer, NFS & John McGinty, Chief Compliance Officer, Fidelity Distributors, to Vanessa Countryman, Secretary, SEC, dated February 16, 2022, in response to File No. SR-FINRA-2022-001, <https://www.sec.gov/comments/sr-finra-2022-001/srfinra2022001-20116307-267950.pdf>.

⁵¹ See note 49, supra.

C. The 2022 Remote Inspections Pilot Program Rule Filing (File No. SR-FINRA-2022-021)

Based on the foregoing, in July 2022, FINRA filed the Initial Rule Filing to amend Rule 3110 to adopt proposed Rule 3110.18 to establish a voluntary, three-year remote inspection pilot program, under terms based largely on Rule 3110.17, but with significant safeguards that would have allowed FINRA the opportunity to collect specified data from pilot program participants to evaluate their experiences and inspection findings in a uniform, comparable manner in the context of then emerging hybrid work model. The SEC twice published the Initial Rule Filing for public comment, which elicited responses from many individuals, broker-dealers, law schools, and trade organizations and other associations, including the Securities Industry and Financial Markets Association, the North American Securities Administrators Association, Inc. (“NASAA”) and the Public Investors Advocate Bar Association (“PIABA”).⁵² The SEC received over 30 comment letters during the course of the two comment periods.⁵³ Most of the comment letters expressed support for the overall objectives of the proposal, and many commenters viewed the proposal as a step towards FINRA rule modernization, and having a positive impact on diversity and inclusion initiatives.⁵⁴ However, four commenters, which included NASAA and PIABA, raised concerns with the Initial Rule Filing.⁵⁵ NASAA and PIABA each submitted two comment letters expressing opposition

⁵² See Submitted Comments to File No. SR-FINRA-2022-021, <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021.htm>.

⁵³ See note 52, *supra*.

⁵⁴ See Exhibit 2c.

⁵⁵ See Exhibit 2c.

to the Initial Rule Filing.⁵⁶ NASAA and PIABA asserted generally that the proposal would adversely impact investor protection due to, among other concerns: the adequacy and scope of the proposed pilot program's controls—the exclusions and conditions—to address higher-risk conduct; the identification of technologies firms would use to conduct their inspections remotely; the fundamental change to the approach of supervision; monitoring for pilot program compliance; and the lack of data to fully support the effectiveness of remote inspections.⁵⁷

FINRA submitted a letter responding to comments⁵⁸ and filed the Amended Rule Filing in December 2022.⁵⁹ The Amended Rule Filing proposed to: (1) add specific risk criteria that a member must consider in making its risk-based evaluation of an office or location; (2) expand the list of exclusions that would make a member ineligible to participate in the proposed pilot program; (3) expand the list of exclusions that would make a specific office or location of a member ineligible for a remote inspection; (4) add express conditions that a member must satisfy to be eligible to conduct remote inspections of any of its offices or locations; (5) add express conditions that a specific office or location of a member must satisfy to be eligible for a remote inspection; and (6) add a new provision to allow FINRA to make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the proposed pilot program for failing to comply with the requirements of proposed Rule

⁵⁶ See note 52, supra.

⁵⁷ See Exhibit 2c.

⁵⁸ See Exhibit 2c.

⁵⁹ See Exhibit 2b.

3110.18. The SEC subsequently published the Amended Rule Filing for public comment,⁶⁰ and during the third comment period, the SEC received four more comment letters, including a third letter from NASAA, stating that in general, while the Amended Rule Filing was an improvement to the proposed pilot program, it still needed more guardrails with respect to the risk assessment; written supervisory procedures; the firm level condition relating to surveillance and technology tools; the data and information collection requirement; and FINRA’s determination of ineligibility for pilot participation.⁶¹ On April 11, 2023, FINRA withdrew File No. SR-FINRA-2022-021 from the SEC to consider whether more guardrails and clarifications to the filing would be appropriate in response to concerns raised by commenters.⁶²

(IV) Proposed Voluntary, Three-Year Pilot Program for Remote Inspections

Proposed Rule 3110.18, which sets forth the terms of the proposed pilot program, would build largely on the terms of Rule 3110.17 and retain the key changes as proposed in the 2022 Remote Inspections Pilot Program Rule Filing, including the areas pertaining to the risk assessment, written supervisory procedures, the firm level condition relating to surveillance and technology tools, and FINRA’s determination of ineligibility for pilot

⁶⁰ See Securities Exchange Act Release No. 96520 (December 16, 2022), 87 FR 78737 (December 22, 2022) (Notice of Filing of Partial Amendment No. 1 to File No. SR-FINRA-2022-021).

⁶¹ See Letter from Andrew Hartnett, President, NASAA, to Sherry R. Haywood, Assistant Secretary, SEC, dated January 12, 2023 (“NASAA III”), <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20154758-323090.pdf>.

⁶² See Exhibit 2d.

participation.⁶³ As detailed below, the proposed rule change would clarify proposed Rule 3110.18 in the areas pertaining to: (1) the frequency of FINRA's data and information collection from pilot program participants, and the type of "findings" that would be part of the collection; and (2) the location level ineligibility criterion for market making and trading activities.

FINRA anticipates that the proposed pilot program will provide broader systemized information to supplement the information obtained through the FINRA examination process in an environment where offices and locations were closed. The information firms would be required to produce as a pilot program participant will help FINRA more accurately assess the overall impact and effectiveness of remote inspections.

FINRA is wholly dedicated to ensuring effective firm supervision as a bulwark against misconduct or misadventure that could harm investors. To this end, FINRA has been in the forefront of developing strong supervision standards for member firms. As FINRA emphasized in the proposed rule change to adopt Rule 3110.17, the responsibility of firms to supervise their associated persons on a day-to-day basis is a critical component of broker-dealer regulation.⁶⁴ FINRA remains committed to ensuring that firms maintain a strong, effective supervisory system, of which the inspection requirement in Rule 3110(c) is a component. Moreover, this inspection requirement is just one facet of a reasonably designed supervisory system; the inspection process is one

⁶³ FINRA is also proposing technical changes that would include, among others, reorganizing the presentation of the proposed rule.

⁶⁴ See note 48, supra.

of several critical components of the broad supervisory process required of member firms to effectively oversee all of their associated persons, regardless of location, compensation or employment arrangement, or registration status. FINRA believes at this time that the proposed pilot program is consistent with a firm's core responsibility, as set forth in Rule 3110, to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Thus, FINRA believes that the remote inspections pilot program's proposed controls and safeguards achieve a responsible balance preserving the investor protection objectives of the rule, while allowing FINRA and the industry to gather data to further evaluate the appropriate contours of the remote inspection construct. FINRA of course welcomes the insights of commenters as FINRA strives to further articulate an effective firm supervisory process.

A. Scope (Proposed Rule 3110.18(a))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(a) would apply to the required inspections of OSJs, branch offices, and non-branch locations under the applicable provisions under Rule 3110(c)(1) for a pilot period of three years starting on the effective date, and expiring on a date that is three years after the effective date. If the proposed pilot program is not extended or Rule 3110.18, as may be amended, is not approved as permanent by the SEC, the proposed supplementary material would automatically sunset on a date that is three years after the effective date. In addition, proposed Rule 3110.18(a) would expressly state that members would not be able to participate in the proposed pilot program after it expires.

B. Risk Assessment (Proposed Rule 3110.18(b))

As described above, Rule 3110(c)(1) provides that an inspection of an office or location must occur on a designated frequency, and the periodicity of the required inspection varies depending on the classification of the location as an OSJ, branch office or non-branch location. Subject to the proposed provisions relating to written supervisory procedures, and the firm and location level requirements as described below, proposed Rule 3110.18(b)(1) would provide that a member firm may elect to conduct the applicable inspection of an office or location during the pilot period remotely, without necessarily an on-site visit for the office or location, when the member reasonably determines that the purposes of the rule can be accomplished by conducting such required inspection remotely.⁶⁵ To address the concerns raised by commenters to the Initial Rule Filing that a firm might not appropriately consider certain higher risk criteria in conducting its risk assessment, the Amended Rule Filing added a non-exhaustive list of factors that a firm must consider and document. FINRA is proposing to retain, without substantive change, those terms under proposed Rule 3110.18(b).

1. Standards for Reasonable Review (Proposed Rule 3110.18(b)(1))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(b)(1) would provide that prior to electing a remote inspection for an office or location, rather than an on-site inspection, the firm must develop a reasonable risk-based approach to using remote inspections and conduct and document a risk assessment

⁶⁵ As described further below, a member firm that elects to participate in the proposed pilot program would be subject to the requirements of proposed Rule 3110.18 for a Pilot Year. See proposed Rule 3110.18(i).

for that office or location. The assessment must document the factors considered, including the factors set forth in Rule 3110.12, and must take into account any higher risk activities that take place or higher risk associated persons that are assigned to that location. FINRA expects that higher risk factors at a particular location would cause a firm to conduct on-site inspections of such location. Further, under the proposed supplementary material, a member that is not eligible to conduct remote inspections under paragraphs (f) or (g) under proposed Rule 3110.18, pertaining to firm level and location level requirements, respectively, must conduct an on-site inspection of that office or location on the required cycle. Finally, notwithstanding the pilot program, a member would remain subject to the other requirements and limitations of Rule 3110(c).⁶⁶

2. Other Factors to Consider for the Risk Assessment (Proposed Rule 3110.18(b)(2))

Consistent with the Amended Rule Filing, FINRA is proposing to set forth a non-exhaustive list of factors that a firm must consider and document as part of the risk assessment. Proposed Rule 3110.18(b)(2) would provide that in addition to the requirements under proposed Rule 3110.18(b)(1), a member would be required to consider other factors in making its risk assessment for remotely inspecting an office or location. These factors would include, among others: (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

⁶⁶ See notes 21 and 22, supra, and accompanying text.

are subject to heightened supervision; (6) failures by associated persons to comply with the member's written supervisory procedures; and (7) any recordkeeping violations. In addition, proposed Rule 3110.18(b)(2) would provide that, consistent with Rule 3110.12, members should conduct on-site inspections or make more frequent use of unannounced, on-site inspections for high-risk offices or locations or where there are indicators of irregularities or misconduct (i.e., "red flags").

In response to the Amended Rule Filing, NASAA recommended that in the absence of an affirmative on-site inspection requirement, a firm should be required to document its reasons for not conducting an on-site inspection of an office or location, particularly if high risk factors or red flags are identified, or the office or location is a private residence.⁶⁷ FINRA believes that Rule 3110.18(b), as proposed herein, reflects NASAA's insight. As noted previously, FINRA emphasizes that the inspection requirement is but one part of a firm's overall supervisory system, and that the inspection, whether done remotely or on-site under the proposed pilot program, would be held to the existing standards of review under Rule 3110.12. Those standards provide, in part, that based on the factors set forth under that supplementary material, members "may need to provide for more frequent review of certain locations." FINRA notes that proposed Rule 3110.18(b) would continue to account for the existing standards for reasonable review under Rule 3110.12 and retain the requirement for a firm, before electing a remote inspection for an office or location, to develop a reasonable risk-based approach to using remote inspections for its offices or locations, and conduct and document a risk assessment. In conducting the assessment, a firm must document the factors considered,

⁶⁷ See NASAA III.

including the factors set forth in Rule 3110.12, and must take into account any higher risk activities that take place or higher risk associated persons that are assigned to that office or location, irrespective of whether such office or location is a private residence. FINRA expects a firm to carefully consider the proposed factors listed above and Rule 3110.12 for the risk assessment. The outcome of such assessment may raise red flags that should prompt a firm to consider, among other things, more frequent inspections of an office or location—be they remote or on-site—than the schedule set forth under Rule 3110(c)(1) (on an announced or unannounced basis). Further, FINRA notes that Rule 3130 (Annual Certification of Compliance and Supervisory Processes) requires member firms to have processes to establish, maintain, review, test, and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable FINRA rules, Municipal Securities Rulemaking Board rules, and federal securities laws and regulations. FINRA expects firms to consider proposed Rule 3110.18 as part of their annual certification process under Rule 3130.

C. Written Supervisory Procedures for Remote Inspections (Proposed Rule 3110.18(c))

As part of an effective supervisory system tailored specifically to the member firm’s business and the activities of all its associated persons, a member must establish and maintain written procedures.⁶⁸ Paragraph (1) (General Requirements) under Rule 3110(b) (Written Procedures) provides that a member must establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the

⁶⁸ See Rule 3110(a)(1); see generally Notice 99-45 and Regulatory Notice 18-15 (April 2018).

activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

Currently, Rule 3110.17(b) expressly provides that consistent with a member's obligation under Rule 3110(b)(1), a member that elects to conduct each of its inspections in the specified calendar years remotely must amend or supplement its written supervisory procedures to provide for remote inspections that are reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with applicable FINRA rules. In addition, under Rule 3110.17(b), reasonably designed procedures for conducting remote inspection of offices or locations should include, among other things, a description of the methodology, including technologies permitted by the member, that may be used to conduct remote inspections. Further, such procedures should include the use of other risk-based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.⁶⁹ To underscore the importance of Rule 3110(b)(1) in the context of the proposed pilot program, FINRA proposed in the 2022 Remote Inspection Pilot Program Rule Filing to add to the elements currently described under Rule 3110.17(b) an express provision that the firm must adopt written supervisory

⁶⁹ Offices or locations that may present a higher risk profile would include, for example, those that have associated persons engaging in activities that involve handling customer funds or securities, maintaining books and records as described under applicable federal securities laws and FINRA rules, order execution as principal or other activities that may be more susceptible to higher risks of operational or sales practice wrongdoing, or have associated persons assigned to an office or location who may be subject to additional or heightened supervisory procedures.

procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. In addition, a firm's written supervisory procedures should also include the factors considered in the risk assessment made for each applicable office or location pursuant to proposed Rule 3110.18(b).

In response to this proposed provision, NASAA stated that a firm's written supervisory procedures should require more prescriptive details such as specifying the technologies a firm would be using "for what purposes[,]" and providing evidence of firm personnel's accessibility to and proficiency with those technologies; describing the circumstances under which a firm would conduct an on-site inspection in the "ordinary course" and as a result of risk indicators and red flags; indicating "whether the firm [intended] to conduct unannounced inspections, how the firm intend[ed] to do so remotely, and whether certain factors might influence the firm's decision to do so in particular [circumstances];" and describing "how [a] firm will use its remote inspection procedures to control for the possibility of active deception."⁷⁰

After considering the specific details recommended by NASAA, FINRA is proposing to largely retain the terms as proposed in the 2022 Remote Inspections Pilot Program Rule Filing as consistent with the tenor of other provisions of Rule 3110. Proposed Rule 3110.18(c) would provide that consistent with a member's Rule 3110(b) obligations, a member that elects to participate in the proposed remote inspection pilot program must adopt written supervisory procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with

⁷⁰ See NASAA III.

applicable securities laws and regulations, and with applicable FINRA rules. Further, under the proposed provision, reasonably designed procedures for conducting remote inspections of offices or locations must address, among other things: (1) the methodology, including technology, that may be used to conduct remote inspections; (2) the factors considered in the risk assessment made for each applicable office or location pursuant to proposed Rule 3110.18(b); (3) the procedures specified in paragraphs (h)(1)(G) and (h)(4) under proposed Rule 3110.18.⁷¹ and (4) the use of other risk-based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.

While the details identified by NASAA may be useful elements for firms to consider in devising reasonably designed procedures, FINRA believes that proposed Rule 3110.18(c), read in conjunction with proposed Rule 3110.18(d), as described below, would provide the appropriate level of direction for firms with respect to technology, the areas that written policies and procedures must address, and the use of other risk-based systems while also staying aligned with the principles underlying Rule 3110. FINRA expects firms to take into account the factors affecting their systems and businesses in crafting reasonably designed policies and procedures to achieve the purposes of the rule.

⁷¹ The areas specified in proposed Rule 3110.18(h)(1)(G) include the procedures for escalating significant findings, new hires, supervising brokers with a significant history of misconduct, outside business activities and doing business as designations, and the areas specified in proposed Rule 3110.18(h)(4) include data and information collection, and transmission.

D. Effective Supervisory System (Proposed Rule 3110.18(d))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, FINRA is proposing to retain the terms of Rule 3110.17(c), without substantive change, in proposed Rule 3110.18(d). Similar to Rule 3110.17(c), proposed Rule 3110.18(d) would expressly reiterate the principle that the requirement to conduct inspections of offices and locations is one part of the member's overall ongoing obligation to have an effective supervisory system, and therefore a member must maintain its ongoing review of the activities and functions occurring at all offices and locations whether or not the member conducts inspections remotely. In addition, proposed Rule 3110.18(d) would provide that a member's remote inspection of an office or location would be held to the same standards for review applicable to on-site inspections as set forth under Rule 3110.12.⁷² Further, proposed Rule 3110.18(d) would provide that where a member's remote inspection of an office or location identifies any indicators of irregularities or misconduct (i.e., "red flags"), the member may need to impose additional supervisory procedures for that office or location, or may need to provide for more frequent monitoring or oversight of that office or location, or both, including potentially a subsequent physical, on-site visit on an announced or unannounced basis.

E. Documentation Requirement (Proposed Rule 3110.18(e))

In general, Rule 3110(c)(2) imposes various documentation requirements for inspections, including maintaining a written record of the date upon which each inspection is conducted. Currently, Rule 3110.17(d) requires supplemental documentation by a member that avails itself of the remote inspection option. The

⁷² See note 23, supra, and accompanying text.

member must maintain and preserve a centralized record for each of calendar years specified in the supplementary material that separately identifies: (1) all offices or locations that had inspections that were conducted remotely; and (2) any offices or locations that the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in Rule 3110.17(c). A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection.

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, FINRA is proposing to incorporate, without substantive change, the terms of Rule 3110.17(d) in proposed Rule 3110.18(e), while making two clarifying changes. One change would be to reference that the centralized record must be for each of the "pilot years" (as defined in proposed Rule 3110.18(1)), and the other change would be to clarify that a member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection, including whether an on-site inspection was conducted at such office.

F. Firm Level Requirements (Proposed Rule 3110.18(f))

In the Initial Rule Filing, FINRA proposed to exclude some member firms from participating in the proposed pilot program. The categories of ineligibility were events or activities of a member firm that FINRA explained were more likely to raise investor protection concerns based on the firm's record of specified regulatory or disciplinary events. Some commenters to the Initial Rule Filing expressed general concerns relating

to the adequacy and scope of those proposed controls—the exclusions and conditions—to address higher risk conduct.⁷³ In response to those concerns, the Amended Rule Filing proposed expanding the list of controls. The proposed rule change would retain, without substantive change, the criteria as set forth in the Amended Rule Filing.

1. Firm Level Ineligibility Criteria (Proposed Rule 3110.18(f)(1))

Under proposed Rule 3110.18(f)(1), a member firm would be ineligible to conduct remote inspections of any of its offices if any time during the pilot period, the member: (1) is or becomes designated as a Restricted Firm under Rule 4111⁷⁴ (proposed Rule 3110.18(f)(1)(A)); (2) is or becomes designated as a Taping Firm under Rule 3170⁷⁵ (proposed Rule 3110.18(f)(1)(B)); (3) receives a notice from FINRA pursuant to Rule 9557 regarding compliance with Rule 4110 (Capital Compliance), Rule 4120 (Regulatory Notification and Business Curtailment) or Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties) (proposed Rule

⁷³ See Exhibit 2c.

⁷⁴ In general, Rule 4111 (Restricted Firm Obligations) requires member firms that are identified as “Restricted Firms” to deposit cash or qualified securities in a segregated, restricted account; adhere to specified conditions or restrictions; or comply with a combination of such obligations. See generally Regulatory Notice 21-34 (September 2021) (announcing FINRA’s adoption of rules to address firms with a significant history of misconduct).

⁷⁵ In general, Rule 3170 (Tape Recording of Registered Persons by Certain Firms) requires a member firm to establish, enforce and maintain special written procedures supervising the telemarketing activities of all of its registered persons, including the tape recording of conversations, if the firm has hired more than a specified percentage of registered persons from firms that meet FINRA Rule 3170’s definition of “disciplined firm.” See generally Regulatory Notice 14-10 (March 2014) (announcing FINRA’s adoption of consolidated rules governing supervision).

3110.18(f)(1)(C)); (4) is or becomes suspended from membership by FINRA (proposed Rule 3110.18(f)(1)(D)); (5) based on the date in the Central Registration Depository (“CRD[®]”) ⁷⁶ had its FINRA membership become effective within the prior 12 months (proposed Rule 3110.18(f)(1)(E)); or (6) is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c) (proposed Rule 3110.18(f)(1)(F)). ⁷⁷

Rules 4111 and 3170 expressly address firms that pose higher risks, and for that reason, those firms would be ineligible to participate in the proposed pilot program. Further, FINRA believes that a member firm that is experiencing issues complying with its capital requirements or has been suspended from membership by FINRA is more likely to face significant operational challenges that may negatively impact the firm’s inspection program. FINRA further believes that a firm that has been a FINRA member for less than 12 months is often still implementing its business plan and may not have sufficient experience to develop a sufficiently robust inspection program. With respect to a firm that is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c), FINRA believes such firms have demonstrated challenges in developing or maintaining robust inspection programs. Collectively, FINRA believes that these proposed ineligibility criteria would appropriately limit the potential population

⁷⁶ CRD is the central licensing and registration system that FINRA operates for the benefit of FINRA, the SEC, other SROs, state securities regulators and broker-dealer firms. The information maintained in the CRD system is reported by registered broker-dealer firms, associated persons and regulatory authorities in response to questions on specified uniform registration forms. See generally Rule 8312 (FINRA BrokerCheck Disclosure).

⁷⁷ FINRA notes that the term “found” as used in this proposed criterion would carry the same meaning as Rule 4530.03 (Meaning of “Found”).

of pilot program participants to those firms that may be better positioned to conduct remote inspections.

2. Firm Level Conditions (Proposed Rule 3110.18(f)(2))

To further address commenters' concerns pertaining to the adequacy and scope of the proposed controls of the pilot program, the Amended Rule Filing proposed enhancing the controls with respect to books and records, and surveillance and technology tools. In that filing, FINRA explained that those conditions were appropriate to establish reasonable baseline requirements for remote inspections. FINRA reaffirms this view through this proposed rule change by retaining, without substantive change, the conditions set forth in the Amended Rule Filing.

a. Recordkeeping System (Proposed Rule 3110.18(f)(2)(A))

As part of the requirements in proposed Rule 3110.18(b) to develop a reasonable risk-based approach to using remote inspections, and to conduct and document a risk assessment for each office or location, the member must, under proposed Rule 3110.18(f)(2)(A), have a recordkeeping system to make and keep current, and preserve records required to be made and kept current, and preserved under applicable securities rules and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110. In addition, such records may not be physically or electronically maintained and preserved at the office or location subject to the remote inspection, and the member has prompt access to such records.

b. Surveillance and Technology Tools (Proposed Rule 3110.18(f)(2)(B))

In response to the Initial Rule Filing, NASAA expressed general concern about the lack of detail on the technology firms use to conduct effective remote surveillance.⁷⁸ Many commenters, however, had countered with the view that advances in technology have facilitated remote surveillance, including inspections, with some commenters describing the technology that they leverage to effectively surveil and inspect offices and locations remotely.⁷⁹ Examples included the use of laptops connected to the firm's network; smart phones for live video calls; video conferencing technology; electronic notifications of shipments to and from an office or location; and internet searches of social media and public records.⁸⁰ To address NASAA's general concerns about surveillance and technology, the Amended Rule Filing provided that as part of the requirement to develop a reasonable risk-based approach to using remote inspections, and the requirement to conduct and document a risk assessment for each office or location, the member must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each such office or location, and set forth a description of the types of tools (e.g., electronic surveillance of e-mail, electronic trade blotters, secure network connections). However, in response to the Amended Rule Filing, NASAA, while acknowledging that supervisory requirements are principles-based, suggested that FINRA should revise the proposed provision to establish a mandatory technology floor for participants in the proposed pilot program comprising the tools commenters listed as examples of effective technologies.⁸¹

As noted above, FINRA is proposing to retain, without substantive change, the condition pertaining to surveillance and technology tools as set forth in the Amended

Rule Filing, as consonant with the principle-based tenor of the rule. Under proposed Rule 3110.18(f)(2)(B), as part of the requirement to develop a reasonable risk-based approach to using remote inspections, and the requirement to conduct and document a risk assessment for each office or location, the member must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each such remotely supervised office or location. The proposed provision would provide that these tools may include but are not limited to: (1) firm-wide tools such as electronic recordkeeping systems, electronic surveillance of e-mail and correspondence, electronic trade blotters, regular activity-based sampling reviews, and tools for visual inspections; (2) tools specifically applied to such office or location based on the activities of associated persons, products offered, restrictions on the activity of the office or location (including holding out to customers and handling of customer funds or securities); and (3) system security tools such as secure network connections and effective cybersecurity protocols. FINRA believes that proposed Rule 3110.18(f)(2)(B) appropriately conveys a reasonable baseline requirement for remote inspections. FINRA maintains that it would not be appropriate to identify specific technology-based tools because of the evolving development and ongoing advances in technologies. Moreover, FINRA notes that proposed Rule 3110.18(c) would require a firm to adopt reasonably designed written supervisory procedures that must include, among other things, a description of the methodology, including the technology, that a firm may use to conduct remote inspections.

G. Location Level Requirements (Proposed Rule 3110.18(g))

In the Initial Rule Filing, FINRA had proposed several criteria that if met would render a member's office or location ineligible for remote inspection. The categories of ineligibility were events or activities of an associated person of the member firm that FINRA had explained were more likely to raise investor protection concerns based on the individual's record of specified regulatory or disciplinary events. Some commenters to the Initial Rule Filing expressed general concerns relating to the discretion provided to firms to make risk assessments as to whether an office or location could undergo a remote inspection.⁸² In response to those concerns, FINRA had expanded the list of events or activities that would deem a specific office or location of a member ineligible from participating in the pilot program. The proposed rule change would retain the criteria set forth in the Amended Rule Filing, but with one clarifying adjustment pertaining to an associated person who is a part of a member's trading desk.

1. Location Level Ineligibility Criteria (Proposed Rule 3110.18(g)(1))

Under proposed Rule 3110.18(g)(1), a member firm's office or location would be ineligible for a remote inspection if at any time during the period of the proposed pilot program, an associated person at such office or location is or becomes: (1) subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or state regulatory agency (proposed Rule 3110.18(g)(1)(A)); (2) statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a

⁸² See Exhibits 2b and 2c.

mandatory heightened supervisory plan under proposed Rule 3110.18(g)(1)(A) or otherwise as a condition to approval or permission for such association (proposed Rule 3110.18(g)(1)(B)); (3) subject to Rule 1017(a)(7)⁸³ as a result of one or more associated persons at such location (proposed Rule 3110.18(g)(1)(C)); (4) one or more associated persons at such location has an event in the prior three years that required a “yes” response to any item in Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4⁸⁴ (proposed Rule 3110.18(g)(1)(D)); (5) one or more associated persons at such office or location is or becomes subject to a disciplinary action taken by the member that is or was reportable under Rule 4530(a)(2) (proposed Rule 3110.18(g)(1)(E));⁸⁵ or (6) the office or location handles customer funds or securities

⁸³ In general, Rule 1017(a)(7) requires a member firm to file a CMA when a natural person seeking to become an owner, control person, principal or registered person of the member firm has, in the prior five years, one or more defined “final criminal matters” or two or more “specified risk events” unless the member firm has submitted a written request to FINRA seeking a materiality consultation for the contemplated activity. Rule 1017(a)(7) applies whether the person is seeking to become an owner, control person, principal or registered person at the person’s current member firm or at a new member firm. See generally Regulatory Notice 21-09 (March 2021) (announcing FINRA’s adoption of rules to address brokers with a significant history of misconduct).

⁸⁴ Form U4’s Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a) elicit reporting of criminal convictions, and Questions 14C, 14D, and 14E pertain to regulatory action disclosures.

⁸⁵ Paragraph (a)(2) under Rule 4530 (Reporting Requirements) requires a member firm to report when an associated person of the member is the subject of any disciplinary action taken by the member involving suspension, termination, the withholding of compensation or of any other remuneration in excess of \$2,500, the imposition of fines in excess of \$2,500 or is otherwise disciplined in any manner that would have a significant limitation on the individual’s activities on a temporary or permanent basis.

(proposed Rule 3110.18(g)(1)(G)).⁸⁶ These proposed criteria remain substantively unchanged from the Amended Rule Filing.

In the Amended Rule Filing, FINRA had also proposed a criterion that would make a member firm's office or location ineligible for a remote inspection if one or more associated persons at such office or location was "a part of the member's trading desk (e.g., engaging in market making activities or having authority to enter proprietary trades on behalf of the member or as agent for other parties)[.]"⁸⁷ In response to the Amended Rule Filing, one commenter conveyed that the proposed criterion was overly broad, and overstated the risks presented by trade desk personnel.⁸⁸ FINRA is proposing to adjust this criterion. As adjusted, under proposed Rule 3110.18(g)(1)(F), a member firm's office or location would be ineligible for a remote inspection if at any time during the period of the proposed pilot program, an associated person at such office or location is engaged in proprietary trading, including the incidental crossing of customer orders, or the direct supervision of such activities.⁸⁹

⁸⁶ In accordance with existing guidance, the meaning and interpretation of the term "handled" that currently appears in Rule 3110(f)(2)(A)(ii) would remain consistent in the proposed pilot program. See also Notice to Members 06-12 (March 2006).

⁸⁷ See Exhibit 2b.

⁸⁸ See Letter from Sandip Khosla, General Counsel, Two Sigma Securities, LLC, to Vanessa A. Countryman, Secretary, SEC, dated January 12, 2023, <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20154757-323056.pdf>.

⁸⁹ FINRA notes that this proposed criterion would encompass trading activity in any security, whether traded on a national securities exchange or over-the-counter.

2. Location Level Conditions (Proposed Rule 3110.18(g)(2))

To further address the concerns about the adequacy and scope of the proposed pilot program's controls, the Amended Rule Filing had proposed enhancing the controls with respect to electronic communications, correspondence and books and records. FINRA is proposing to retain, without substantive change, the conditions set forth in the Amended Rule Filing. Under proposed Rule 3110.18(g)(2), as part of the requirement to develop a reasonable risk-based approach to using remote inspections, and the requirement to conduct and document a risk assessment for each office or location, the member must satisfy the following conditions: (1) electronic communications (e.g., e-mail) are made through the member's electronic system; (2) the associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with Rule 3110; and (3) no books or records of the member required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110 are physically or electronically maintained and preserved at such office or location. FINRA believes that proposed Rule 3110.18(g)(2) appropriately conveys a reasonable set of conditions related to communications of associated persons and the creation and preservation of books and records at a specific office or location.

FINRA believes that the proposed location level ineligibility criteria are indicia of increased risk to investors at some office or locations, such that they should not be eligible for remote inspections in accordance with the proposed pilot program.

A member firm, or an office or location subject to one of the categorical restrictions would not be eligible for remote inspections, even if the firm's risk

assessment concludes that a remote inspection would be appropriate. A member firm that meets one of these ineligibility criteria would not be able to participate in the proposed pilot program. If a member firm is eligible to participate in the proposed pilot program, but one of its offices or locations meets one of the location level ineligibility criteria, the member would be required to conduct an on-site inspection of that office or location on the required cycle. FINRA believes the proposed list of ineligibility categories is appropriately derived from existing rule-based criteria that are part of processes to identify firms that may pose greater concern (e.g., Rules 4111 and 3170) or associated persons that may pose greater concerns due to the specified activities and nature of disclosures of regulatory or disciplinary events on the uniform registration forms. FINRA believes that these objective categorical restrictions will provide safeguards that will help ensure that firms maintain effective supervisory procedures during the pilot period.

H. Data and Information Collection Requirement (Proposed Rule 3110.18(h))

1. Data and Information (Proposed Rule 3118.18(h)(1))

As noted above, Rule 3110.17 was adopted in the midst of the pandemic and operationalized in an environment in which many offices and locations were closed to the public. FINRA believes that the formalized, uniform collection of data is critical to allow FINRA to meaningfully assess the effectiveness of remote inspections to help shape potential permanent amendments to Rule 3110(c) that would optimize an inspection program in the evolving workplace environment. FINRA believes having a pilot program for remote inspections with appropriate conditions, limitations and documentation requirements in an environment that is settling into a hybrid workplace

model would provide a clearer picture of the strengths and weaknesses of remote inspections, without compromising investor protection. Proposed Rule 3110.18(h), the terms of which are similar to those set forth in the 2022 Remote Inspections Pilot Program Rule Filing, would impose upon firms a data and information collection requirement as a condition for participating in the pilot program. On a quarterly frequency, participating firms would be required to collect and produce to FINRA, in a manner and format determined by FINRA, data consisting of separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations, consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110, for several categories. These categories include: (1) the total number of inspections—on-site and remote—completed during each calendar quarter;⁹⁰ (2) the number of those office or locations in each calendar quarter that were subject to an on-site inspection because of a “finding,” (as described under proposed Rule 3110.18(h)(1) as a discovery made during an inspection that led to a remedial action or was listed on the member’s inspection report);⁹¹ (3) the number of locations for which a remote inspection was conducted in the calendar quarter that identified a finding, the number of findings, and a list of the most significant findings;⁹² and (4) the number of locations for which a on-site inspection was

⁹⁰ See proposed Rule 3110.18(h)(1)(A), (B) and (C).

⁹¹ See proposed Rule 3110.18(h)(1)(D).

⁹² See proposed Rule 3110.18(h)(1)(E). A “significant finding” would be one that should prompt the firm to take further action that could include escalation to the appropriate channels at the firm for further review, the result of which may be enhanced monitoring or surveillance of a particular event or activity through more frequent inspections (remotely or on-site), on an announced or unannounced basis, of the office or location, or other targeted reviews of the root cause of the finding. Examples of some findings that may prompt escalation or further internal review by the appropriate firm personnel include, among other things, the

conducted in the calendar quarter that identified a finding, the number of findings, a list of the most significant findings.⁹³ In addition, firms would be required to provide FINRA their written supervisory procedures for remote inspections that account for: (1) escalating significant findings; new hires; supervising brokers with a significant history of misconduct; and outside business activities and “doing business as” (or DBA) designations.⁹⁴ Firms would be required to provide FINRA with a copy of these written supervisory procedures alongside the first delivery of the data points described above, and any subsequent amendments to such procedures for remote inspections.⁹⁵

In response to the Amended Rule Filing, NASAA suggested that firms should be required to provide FINRA with “‘all findings’ made during remote inspections, not only the ones the firm subjectively deems ‘most significant’[,]” contending that the discretion given to firms to make this determination would undermine the data and hinder FINRA’s ability to assess trends and developments.⁹⁶ FINRA believes that to require firms to provide “all findings” rather than the “significant findings” would yield an overly broad data set where it would be challenging to discern key trends in a meaningful way. Moreover, while Rule 3110(c)(2) specifies the areas that a firm must address in an inspection report, if applicable to the office or location being inspected, the rule does not

use of unapproved communication mediums, customer complaints, or undisclosed outside business activities or private securities transactions.

⁹³ See proposed Rule 3110.18(h)(1)(F).

⁹⁴ See proposed Rule 3110.18(h)(1)(G)(i) through (iv).

⁹⁵ See proposed Rule 3110.18(h)(1)(G).

⁹⁶ See NASAA III.

impose any other content requirements of an inspection report. FINRA believes that pilot program participants, which FINRA would expect to reflect a variety of attributes (e.g., size, business model, organizational structure), should have the agency to assess their significant findings and report them to FINRA in the manner specified under the proposed rule. FINRA maintains that this approach would enhance FINRA's ability to review a discrete set of data that would focus on key areas of concern to firms, which in turn, would help FINRA assess the effectiveness of remote inspections.

2. Additional Data and Information for Pilot Year 1, if Less Than Full Calendar Year (Proposed Rule 3110.18(h)(2)) and for Calendar Year 2019 (Proposed Rule 3110.18(h)(3))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(h)(2) would address the additional data and information requirements for Pilot Year 1 (as defined under proposed Rule 3110.18(l)), if such year covers a period that is less than a full calendar year. In such case, a member that elects to participate in the proposed pilot program would be required to collect the following data and information and provide such data and information to FINRA (in a manner and format FINRA determines) no later than December 31 of such first Pilot Year. For items (1) through (3) below, a member would be required to provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110: (1) the number of locations with an inspection completed during the full calendar year of the first Pilot Year; (2) the number of locations in item (1) that were inspected remotely during the full calendar year of the first Pilot Year; and (3) the number of locations in item (1) that were inspected on-site during the full calendar year of the first Pilot Year. This additional data

and information would provide FINRA the ability to capture, in the aggregate, complete inspection counts—total number of Rule 3110(c)(1) inspections (remote and on-site)—for the entire calendar year in addition to the more detailed data and information requirements under proposed Rule 3110.18(h)(1).

In response to the Amended Rule Filing, NASAA recommended that firms be required to provide FINRA with the information specified in the proposed provision relating to data and information collection to cover the most recent 12-month period during which the firm conducted in-person inspections under Rule 3110(c). FINRA agrees with this approach. Thus, in addition to the data and information requirement under paragraphs (h)(1) and (h)(2) to proposed Rule 3110.18, proposed Rule 3110.18(h)(3) would require a pilot program participant to collect and provide to FINRA calendar year 2019 data and information no later than December 31 of Pilot Year 1 (as defined under proposed Rule 3110.18(l)). For items (1) and (2) below, a member would be required to provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110: (1) the number of locations with an inspection completed during calendar year 2019; and (2) the number of locations in item (1) where findings were identified, the number of those findings and a list of the most significant findings. This additional data and information covering calendar year 2019, when firms conducted their inspections solely on-site, would provide FINRA with some baseline data and information about on-site inspections immediately preceding the pandemic.

3. Written Policies and Procedures (Proposed Rule 3110.18(h)(4))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(h)(4) would remind firms of the general requirement to establish, maintain and enforce written policies and procedures that are reasonably designed to comply with the data and information collection, and transmission requirements of the proposed pilot program.

I. Election to Participate in Remote Inspections Pilot Program (Proposed Rule 3110.18(i))

Consistent with the 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(i) would set forth the manner in which a firm would notify FINRA of the firm's election to participate in the proposed pilot program and to withdraw from it. The proposed rule would provide that FINRA may, in exceptional cases and where good cause is shown, waive the applicable timeframes described below for the required opt-in or opt-out notices.

Proposed Rule 3110.18(i) would require a firm, at least five calendar days before the beginning of such Pilot Year, to provide FINRA an "opt-in notice" in the manner and format determined by FINRA. By providing such opt-in notice to FINRA, the firm agrees to participate in the proposed pilot program for the duration of such Pilot Year and to comply with the requirements of Rule 3110.18.⁹⁷ A firm that provides the opt-in notice for a Pilot Year would be automatically deemed to have elected and agreed to participate in the Remote Inspections Pilot Program for subsequent Pilot Years (i.e., Pilot

⁹⁷ A firm that participates in a Pilot Year would be committed to complying with the terms of proposed Rule 3110.18 for that Pilot Year.

Year 2, Pilot Year 3, and Pilot Year 4, if applicable) until the pilot program expires.

Further, proposed Rule 3110.18(i) would describe the notice requirement for a firm to withdraw from the proposed pilot program. A firm would be required to provide FINRA with an “opt-out notice” at least five calendar days before the end of the then current Pilot Year.

By way of example, a firm that provides FINRA an opt-in notice on June 26 to join Pilot Year 1 that begins on July 1 would be automatically deemed to continue participating in Pilot Year 2 unless the firm provides FINRA the required opt-out notice no later than December 26 of Pilot Year 1. To continue with this example, a firm that was automatically deemed to participate in Pilot Year 2 and determines in mid-Pilot Year 2 that it does not want to automatically continue into Pilot Year 3 could elect to withdraw from Pilot Year 3 if it provides FINRA an opt-out notice at least five calendar days before the end of Pilot Year 2. However, because Pilot Year 2 is already underway, the firm would be required to complete Pilot Year 2 in accordance with proposed Rule 3110.18.

FINRA believes that this proposed operational aspect of the program would not only establish a cohesive process in which firms and FINRA may manage program participation but also lend some continuity in data and information collection that would support FINRA’s assessment and evaluation of the experiences of pilot program participants.

J. Failure to Satisfy Conditions (Proposed Rule 3110.18(j))

Consistent with 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(j) would address a situation in which a firm fails to satisfy terms of the

proposed pilot program. The proposed paragraph would provide that a firm that fails to satisfy the conditions of Rule 3110.18, including the requirement to timely collect and submit the data and information to FINRA as set forth in proposed Rule 3110.18(h), would be ineligible to participate in the pilot program and must conduct on-site inspections of each office and location on the required cycle in accordance with Rule 3110(c).

K. Determination of Ineligibility (Proposed Rule 3110.18(k))

To address commenters' concerns pertaining to monitoring for compliance with the proposed pilot program, the Amended Rule Filing had proposed a provision to allow FINRA to make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the proposed pilot program if the member fails to comply with the requirements of the proposed pilot program. The proposal further provided that FINRA would provide written notice to the member of such determination and such member would no longer be eligible to participate in the proposed pilot program and would be required to conduct on-site inspections of required offices and locations in accordance with Rule 3110(c). In the Amended Rule Filing, FINRA had explained that this authority would both align with FINRA's examination and risk monitoring programs for member firms and registered persons and allow FINRA to more effectively assess higher risk. In response to the Amended Rule Filing, NASAA stated that the proposed provision should be expanded broadly to provide FINRA the ability to make such a determination if it finds that a firm "fail[ed] to comply with the requirements of applicable laws, rules, and regulations related to supervision of

associated persons[,]” stating that this broad scope would provide the appropriate level of flexibility “to protect investors from misconduct and lax supervisory practices.”⁹⁸

FINRA believes that the proposed provision is sufficiently broad in scope for purposes of the proposed pilot program. FINRA reiterates that the purpose of the proposed three-year pilot program, which is voluntary, is to study the effectiveness of remote inspections in accordance with Rule 3110(c)(1) as part of a reasonably designed supervisory system. Consistent with the Amended Rule Filing, FINRA is proposing to retain, without substantive change, proposed Rule 3110.18(k) under the described terms.

L. Definitions (Proposed Rule 3110.18(l))

Consistent with 2022 Remote Inspections Pilot Program Rule Filing, proposed Rule 3110.18(l) would set forth the meanings underlying “Pilot Year” to explain the duration of the proposed pilot program. Under proposed Rule 3110.18(l), a “Pilot Year” would mean the following: (1) Pilot Year 1 would be the period beginning on the effective date of the proposed pilot program and ending on December 31 of the same year; (2) Pilot Year 2 would mean the calendar year period following Pilot Year 1, beginning on January 1 and ending on December 31; and (3) Pilot Year 3 would mean the calendar year period following Pilot Year 2, beginning on January 1 and ending on December 31. Finally, if applicable, where Pilot Year 1 covers a period that is less than a full calendar year, then Pilot Year 4 would mean the period following Pilot Year 3, beginning on January 1 and ending on a date that is three years after the effective date.

⁹⁸

See NASAA III.

M. Sunset of Rule 3110.17 (Proposed Rule 3110.18(m))

As noted above, Rule 3110.17 is set to expire on December 31, 2023.⁹⁹ FINRA will submit a separate rule filing if, during the pendency of the SEC's determination of whether to approve or disapprove this proposed rule change, FINRA seeks to extend the duration of Rule 3110.17 beyond the current term. Proposed Rule 3110.18 would expressly account for the possibility of overlapping provisions if the proposed pilot program becomes effective while Rule 3110.17 is also in effect. Proposed paragraph (m), which is nearly identical to the provision set forth in the 2022 Remote Inspections Pilot Program Rule Filing, would provide that if Rule 3110.17 has not already expired by its own terms (on December 31, 2023 or as the case may be, on an extended date), it would automatically sunset on the effective date of proposed Rule 3110.18.

Consistent with the principles set forth in prior guidance, FINRA expects members to establish reasonably designed inspection programs. The proposed pilot program for remote inspections does not alter the core obligation of a member firm to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.¹⁰⁰ As part of the inspection planning process, FINRA expects members to continue with their ongoing supervision, including risk analysis of the activities and functions occurring at all offices or locations. While the option to conduct remote inspections in accordance with proposed Rule 3110.18 provides greater choice in how to effectively supervise some offices or locations, a member must

⁹⁹ See note 49, *supra*.

¹⁰⁰ See Rule 3110(a).

continue to consider the factors described in Rule 3110.12, along with the activities taking place there. This analysis may require the member to conduct a physical, on-site inspection of an office or location. Where there are indications of problems or red flags at any office or location, FINRA expects members to investigate them as they would for any other office or location subject to Rule 3110(c), which may include an unannounced, on-site inspection of the office or location. FINRA is committed to diligently monitoring the impacts of remote inspections on a firms' overall supervisory systems and reviewing the data over the life of the proposed pilot program to assess how firms apply the flexibility provided by the pilot program while maintaining an effective supervisory program.

(V) FINRA's Monitoring and Compliance with Proposed Rule 3110.18

A. Overview of FINRA's Data-Driven, Risk-Based Regulatory Framework

FINRA's data-driven regulatory programs are integrated among various FINRA departments, and the data and information FINRA currently collects from its member firms helps provide FINRA with a holistic view of firm risk management. FINRA's Examinations and Risk Monitoring Program, which is a part of FINRA's Member Supervision Department, is a critical component of FINRA's regulatory operations, and one of the many ways in which FINRA oversees the activities of member firms and its associated persons with the goal of detecting, deterring, and addressing activities that may cause investor harm or adversely impact market integrity.¹⁰¹

¹⁰¹ See generally FINRA Examination and Risk Monitoring Programs, <https://www.finra.org/rules-guidance/key-topics/finra-examination-risk-monitoring-programs>.

FINRA's Risk Monitoring is organized by the primary business model of member firms¹⁰² and serves as a point of contact for FINRA member firms on a range of topics that may include, among others, financial and business conduct requirements and firm submissions (e.g., FOCUS filings, Rule 4530 filings, other reporting requirements), published guidance, and new FINRA rules. This relationship allows Risk Monitoring to cultivate a thorough understanding of the business activities and operations of each firm they monitor. This knowledge, along with the data FINRA collects serves FINRA by providing ongoing awareness and analysis of member firm activities, including business lines, operations, products, and controls. This proactive monitoring, with Risk Monitoring as the point of contact for member firms, enables FINRA to implement a risk-based regulatory program that focuses resources and regulator responses on concerning risks. This assessment methodology plays a role in many aspects of FINRA's regulatory programs, including FINRA's Examinations in the preparation of firm examinations. The type of examination may depend upon the firm profile that is created by a number of attributes, including among others, business model, size, the products offered, and disciplinary history of the firm and its registered persons. The areas of review in an examination may also be influenced by the adoption of a new FINRA rule and any accompanying guidance or interpretation.

As described above, the terms of proposed Rule 3110.18 include several rule-based or reportable criteria, or information that is electronically captured that FINRA can readily monitor through Risk Monitoring and Examinations. These criteria relate to

¹⁰² The five business models are Capital Markets, Carrying and Clearing, Retail, Trading and Execution, and Diversified.

Rules 1017(a)(7), 3170, 4111, and 9557, the suspension of FINRA membership, or a FINRA membership that has been effective for less than 12 months, among other criteria set forth in the proposed supplementary material. Activity-based criteria such as market-making and trading activities, and the handling of customer funds or securities can also be surveilled through firm submissions, and other data sources and internal systems.

FINRA recognizes that firms are using increasingly sophisticated technology and analytic techniques to synthesize data in ways not previously possible to identify indicators of possible rule violations and associated person misbehavior. To keep pace with the technological environment, FINRA's regulatory programs are also data driven, and FINRA uses its data and information (e.g., Forms U4 and U5, regulatory tips, transaction reporting, and other internal and externally-acquired data), gathered, in part, through advanced analytics, to better identify and address risks that can be marked not only to a member firm, but also to a registered person. The picture that the data and information reveal may initiate an examination separate from the firm's routine examination or, through Risk Monitoring, further inquiry with the firm.

In the context of the proposed remote inspections pilot program, FINRA would use the risk markers identified using its analytic techniques to inform FINRA's Risk Monitoring and Examinations' assessment of whether FINRA should examine an office or location, and in turn, examine a firm's reasonableness determination to conducting remote inspections rather than an on-site inspection for that office or location. Some risk markers may include, among others, CRD disclosures, the number and types of OBAs of registered persons at a specific office or location, the existence and type of investor harm events that have occurred for individuals at an office or location, the historical results and

frequency of FINRA's examination of an office or location, and the percentage of senior investors in the county in which the office or location reside, among others. Relatedly, FINRA is able to leverage this data and information when assessing the reasonableness of a firm's supervision, including their determination to inspect an office or location through a remote process, rather than an on-site process. For example, if the data and information identify an office or location with a concentration of OBAs or investor harm events and review of the firm's remote inspection program does not appear to account for OBAs or sales risks, there may be an overall weakness in the firm's inspection program, irrespective of whether the inspection is done remotely or on-site. As with any new process or rule, FINRA anticipates undertaking a careful review of firm compliance with proposed Rule 3110.18. FINRA is engaged in ongoing efforts to enhance its regulatory programs, with a sustained focus on effectively identifying and addressing areas of risk by firm and registered person. Several of FINRA's key functions provide early warning indicators of potential problems, which FINRA leverages in its regulatory oversight of firms. In the context of reviewing a firm's remote inspections program, one indicator in this evaluation may be whether the firm is identifying risk indicators that are similar to those that FINRA is detecting.

B. FINRA's Use of the Data and Information Collected in
Accordance with Proposed Rule 3110.18(h)

In general, proposed Rule 3110.18(h) would require a pilot program participant to provide FINRA with specified data and information (in an aggregated form), including written supervisory procedures for remote inspections, that FINRA believes would complement FINRA's existing regulatory intelligence as part of the larger effort to gauge the effectiveness of remote inspections as part of a reasonably designed supervisory

system. For purposes of its regulatory programs and if appropriate, FINRA may, after some experience with the data and information collected, extrapolate trends and practices in this area that could result in future rulemaking or updated guidance about inspections generally.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁰³ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The terms of the proposed voluntary, three-year remote inspection pilot program, while based largely on the terms of Rule 3110.17, which has been operational since the latter part of 2020 and is set to automatically sunset on December 31, 2023,¹⁰⁴ would include important safeguards that would require individual risk assessments of each office, supplemental written supervisory procedures related to remote inspections, documentation requirements and obligations to share data with FINRA to allow for assessment of the pilot program. The proposed rule change is intended to provide firms that are operating in a hybrid work environment the option to conduct remote inspections of their offices and locations, subject to specified conditions, while maintaining effective

¹⁰³ 15 U.S.C. 78o-3(b)(6).

¹⁰⁴ See note 49, supra.

supervision. FINRA believes that the proposed pilot program would provide FINRA the appropriate amount of time and population sample to better evaluate the use of remote inspections in the unfolding office work environment. FINRA believes the proposed pilot program, with the proposed safeguards and controls, will provide firms more flexibility to adapt to changing work conditions. The proposed pilot program would aid in FINRA's assessment of the effectiveness of a flexible remote inspection option and its utility in an environment that is increasingly moving to hybrid workplace models, without compromising investor protection.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to the current baseline, and the alternatives FINRA considered in assessing how best to meet FINRA's regulatory objectives.

1. Regulatory Need

The proposed pilot program would serve two purposes. First, it would mitigate potential disruptions to the hybrid work arrangements that have developed during the pandemic. In particular, for participating members, the proposed pilot program would limit the increase in aggregate inspection costs, and the resulting incentive to reduce the

number and type of work locations, that would occur when temporary relief provided during the pandemic expires.¹⁰⁵ The proposed pilot program would not eliminate the need for such adjustments, but it would allow member firms to focus their on-site inspections on riskier locations.

The proposed pilot program would also allow FINRA to assess the benefits and costs of allowing some element of remote inspection of branch offices and non-branch locations, under specified conditions, in the post-pandemic world. FINRA would obtain information from participating members on certain elements of the risk-based approach that they implement, the type and frequency of inspections, and certain outcomes conditional on the type and frequency of inspections, as well as the type of office or location inspected.

2. Economic Baseline

The economic baseline for the proposed rule change includes both current and foreseeable workforce arrangements and business practices, including those that were first developed during the pandemic and have been modified since. In particular, the economic baseline includes the innovations, and investments in communication and surveillance technology, that have supported and continue to support supervision in the

¹⁰⁵ According to the April Survey of Working Arrangements and Attitudes (SWAA), post-COVID, many employers are planning to allow employees to work from home approximately 2.2 days per week, on average. See Jose Maria Barrero, Nicholas Bloom, Shelby Buckman & Steven J. Davis, SWAA February 2023 (February 12, 2023), https://wfhresearch.com/wp-content/uploads/2023/02/WFHRsearch_updates_February2023.pdf. The SWAA is a monthly survey with respondents that are working-age persons in the United States that had earnings of at least \$10,000 in 2019. Further details about this survey can be found in <https://wfhresearch.com>.

remote work environment.¹⁰⁶ These innovations and investments were developed during the temporary relief allowing remote inspections in Rule 3110.17, and the temporary suspension of the requirement to submit branch office applications on Form BR for new office locations provided in Notice 20-08 (“Form BR Relief”). The baseline includes the scheduled expiration of Rule 3110.17 on the effective date of the proposed Rule 3110.18; and, in order to provide a full accounting of the likely effects of the proposed rule change, the analysis also assumes that, going forward, the temporary suspension of the above requirement is no longer in effect. FINRA expects that numerous additional office locations would then need to be registered, greatly expanding the number of inspections, and all inspections would then need to be conducted on-site.

As of December 31, 2022, FINRA’s membership included 3,381 firms with 150,495 registered branch offices.¹⁰⁷ Of these branch offices, 18,564 (12%) are OSJs subject to an annual inspection requirement. The remaining 131,931 branch locations are non-OSJ branch offices subject to an inspection requirement at least annually or every three years. In addition, according to FINRA estimates, there are approximately 59,830 non-branch locations, of which 41,078 are private residences.¹⁰⁸ A non-branch location

¹⁰⁶ The pandemic propelled increased reliance on technology solutions in the remote work environment. A McKinsey survey in late 2020 found that, overall, firms had accelerated their adoption of technology, with large accelerations in the implementation of changes to increase remote working and collaboration, as well the use of advanced technologies in operations. See McKinsey & Company, How COVID-19 has pushed companies over the technology tipping point—and transformed business forever (October 5, 2020), <https://mck.co/3nIK8b2>.

¹⁰⁷ This count excludes firms with membership pending approval, and withdrawn or terminated from membership.

¹⁰⁸ Non-branch locations do not have to be registered with FINRA. The estimates for non-branch locations, including those that are also private residences, are obtained by reviewing Form U4. There may be some double counting of non-branch

must be inspected on a periodic schedule, presumed to be at least every three years.

These data may be affected by the temporary relief from certain requirements to update Form U4 and to submit Form BR provided in Notice 20-08. FINRA estimates that member firms conduct at least 82,500 inspections per year.

3. Economic Impacts

When the Form BR Relief ends,¹⁰⁹ FINRA expects that numerous additional office locations will need to be registered, greatly expanding the number of inspections, and all inspections would then need to be conducted on site. The economic impacts of these changes would be mitigated by the proposed rule change for firms that choose to participate in the pilot program.¹¹⁰

locations if members record the address differently on more than one Form U4. For the estimate of non-branch locations, FINRA counted, by firm, unique addresses based on the first seven characters of the Form U4 “Street 1” field, city and state. Addresses that matched the address of the main office or of an existing registered branch were excluded.

¹⁰⁹ When appropriate, FINRA will announce a termination date for the regulatory relief set forth in Notice 20-08 that will provide members with time to make necessary operational adjustments. See generally FINRA’s Key Topic: COVID-19/Coronavirus (referencing, among other things, Frequency Asked Questions Related to Regulatory Relief Due to the Coronavirus Pandemic), <https://www.finra.org/rules-guidance/key-topics/covid-19/faq>.

¹¹⁰ Separately, FINRA filed a proposed rule change to establish a Residential Supervisory Location (“RSL”), a new non-branch location, that would, relative to the baseline, reduce the number of inspections that members with RSLs would need to conduct in a year. See Securities Exchange Act Release No. 97237 (March 31, 2023), 88 FR 20568 (April 6, 2023) (Notice of Filing of File No. SR-FINRA-2023-006) (“2023 RSL Rule Filing”). For member firms with locations that would meet the proposed definition of an RSL, the aggregate cost savings from choosing to participate in the proposed pilot program would be lower if the RSL proposal were in place because the cost savings from remote inspections would accrue over fewer inspections. The qualitative impacts of the proposed pilot program, however, are similar whether the proposed definition of an RSL is adopted or not.

The requirements in the Proposed Rule 3110.18 would exclude some member firms entirely or partially by excluding some of their offices or locations from participating in the Remote Inspections Pilot Program. The proposed additional requirements reference events or activities of a member firm or its associated person where remote inspection may result in an increased risk to investors.

Using CRD data as of early November 2022, FINRA estimates that under the firm level exclusions from the Initial Proposal, at least approximately 128 firms with 474 registered branches would not qualify for the proposed pilot program. Under the office or location level exclusions, an additional 868 registered branch offices belonging to 278 other firms would be excluded. Thus, a total of approximately 1,342 (= 474+868) registered branch offices would be excluded from the proposed pilot program.¹¹¹ Based on these figures, FINRA anticipates that at most approximately 2,884 small firms, 183 mid-size firms and 166 large firms could potentially participate in the proposed pilot program and that most large firms would have some branch offices excluded.

Participants in the pilot program would be expected to take a risk-based approach to conducting remote inspections. A firm that does not conduct a remote inspection for an office or location must conduct an on-site inspection of that office or location on the required cycle and remains subject to the other requirements of Rule 3110(c). A firm that

¹¹¹ Approximately 1,766 firms have a single registered branch office and ten or fewer registered representatives or no registered branch offices. FINRA anticipates that such firms would be less likely to elect to participate in the proposed pilot program. The reason is that it is less likely that these firms would have enough staff working from home such that the benefit of conducting remote inspections relative to the cost of sending data to FINRA and meeting the other proposed pilot program requirements would make participation in the proposed pilot program more practical than conducting physical inspections or eliminating remote work.

chooses to participate in the pilot program (assuming that it is not otherwise ineligible from participating) would also be required to provide FINRA with certain data and other information about the risk-based approach that they implement, the type and frequency of inspections, and certain outcomes conditional on the type and frequency of inspections.

Anticipated Benefits

The benefit to eligible firms of choosing to participate in the pilot program, in an improved health environment, would result from limiting the increase in travel costs and lost productivity due to time spent during travel and in the on-site inspection. On-site visits have material costs from travel expenses and additional staff time. A system of risk-based on-site and remote inspections will allow firms to more efficiently deploy compliance resources and to use an on-site component only when appropriate.

Firms as well as investors may benefit if remote inspections provide new flexibility in the design of inspection teams. For example, remote inspections may facilitate the development of specialized inspection staff that are deployed over more inspections, for shorter periods of time, in a targeted way. This option may especially benefit diversified member firms with a variety of product offerings. Remote inspections can also facilitate the use of inspections that target a particular area of focus in a member firm's business across all branches of the member firm.

The proposed rule change may also support the competitiveness of the broker-dealer industry for individuals who seek professional positions in compliance.¹¹² The

¹¹² See note 106, *supra*. See also Jose Maria Barrero, Nicholas Bloom & Steven J. Davis, Why Working from Home Will Stick (NBER Working Paper 28731, April 2021), <https://wfhresearch.com/wp-content/uploads/2021/04/w28731-3-May-2021.pdf>, who point to a lasting effect of the pandemic on work arrangements, in particular for those with higher education and earnings; and Alexander Bick,

expectation of workplace flexibility and remote work by such individuals may lead them away from the broker-dealer industry if other segments of financial services or professional occupations offer more flexible workforce arrangements, with regulatory frameworks that offer more discretion in how the supervision is conducted.¹¹³ Even prior to the pandemic, the scope of on-site inspections had been much reduced due to technological surveillance solutions and centralization of books and records. The proposed pilot would support continued adoption and innovation in technological solutions and reductions in the cost of these solutions.¹¹⁴

Participants in the proposed pilot program would provide FINRA with quarterly data on the frequency and type of inspections (on-site or remote), counts of findings from inspections subdivided by category of office or location, qualitative information about these findings, and certain information about the written supervisory procedures for

Adam Blandin & Karel Mertens, Work from Home Before and After the COVID-19 Outbreak, (Working Paper, October 2022), https://karelmertenscom.files.wordpress.com/2022/11/wfh_oct_15_paper.pdf, who find consistent results, with a higher adoption rate of work from home jobs in Finance and Insurance, relative to other industries, reflected in Figure 10. Both papers, based on different surveys and, in Bick et al, with added results from a model, conclude that around 22% of full workdays will be provided from home in the long run.

¹¹³ For example, Advisers Act Rule 206(4)-7 does not require Registered Investment Advisers to conduct in-person inspections or reviews of its offices or personnel.

¹¹⁴ See Ben Charoenwong, Zachary T. Kowaleski, Alan Kwan & Andrew Sutherland, RegTech (MIT Sloan Research Paper 6563-22, September 16, 2022), <http://dx.doi.org/10.2139/ssrn.4000016>. The authors show that broker-dealers that made compliance technology investments in response to the 2014 amendment of Exchange Act Rule 17a-5 were able to make complementary technology investments in communications and customer relationship management software. These resulted in a reduced number of complaints and less employee misconduct.

remote inspections they are required to have.¹¹⁵ Depending on the number and types of firms that participate in the proposed pilot program, this data may allow FINRA to identify differences in risks between remote versus on-site inspection, both conditional on the observable characteristics and policies of firms and overall, the extent of variation in these risks across firms and firm characteristics, and factors associated with very high or low risks.¹¹⁶ The proposed pilot program has the potential to yield a more thorough collection of sensitive information in a structured manner than voluntary submissions or a survey of FINRA members could provide. This data will be useful both for monitoring for risks as the pilot proceeds and, with sufficient participation, for developing a balanced assessment of the potential impact of permitting further remote inspection.

Anticipated Costs

Participation in the proposed pilot program is voluntary, and the proposed rule change provides firms with an additional method for complying with certain supervisory requirements without removing other methods of compliance. Eligible pilot program participants will therefore participate in the pilot program only if doing so is beneficial to their operations relative to complying with current Rule 3110. The cost of complying with the requirements of the proposed pilot program is a factor in this decision. These costs include conducting risk-based analyses for inspections and providing aggregated data on findings to FINRA. The data request in particular may require more

¹¹⁵ In addition, if the effective date of the rule is such that the first year of the pilot program covers a period less than a full calendar year, participating firms would be required to provide, the data and information specified in proposed Rule 3110.18(h)(2).

¹¹⁶ In addition, analysis of trends over time will need to consider changes in the macroeconomic environment.

standardization and aggregation of inspection findings than some member firms typically conduct. The data request may also not use the same terms or formats used by compliance officers for reporting and tracking inspection findings. Firms may need to develop new written supervisory procedures and new trainings for compliance staff to ensure that all required data is accurate and compiled and submitted to FINRA in a timely manner. Firms will incur new ongoing costs both for compliance and monitoring for compliance.

Supervision and inspections are intended to identify not only the activities that violate member procedures or FINRA rules but also poor practices that might ultimately allow for such violations. FINRA recognizes that remote inspections may be less likely to identify such practices or activities as on-site inspections. FINRA believes that risks to member firms and investors from remote inspections are mitigated by the proposed requirements to have written supervisory procedures for remote inspections, the proposed requirement to conduct and document risk assessments, the proposed limitations on the firms and locations that would be eligible to participate in the proposed pilot program, and the technology already employed for day-to-day supervision. In addition, FINRA will continue to closely monitor the outcomes of examinations during the pilot program period.

4. Alternatives Considered

The proposed pilot program would continue for three years. FINRA staff considered alternative durations for the program. FINRA members firms vary by business model and organizational structure, so a shorter program is less likely to yield enough data on inspection findings to allow for meaningful comparisons between on-site

and remote inspection regimes across members. In addition, inspections are typically planned by members well ahead of time, so some members may not implement the requirements of the program until well into the duration of the pilot program. It may also help firms and the policy development process if FINRA had enough data to meaningfully evaluate well ahead of the expiration of the pilot program.

As discussed above, the requirements in proposed Rule 3110.18 would exclude some member firms entirely or partially by excluding some of their offices or locations from participating in the proposed pilot program. FINRA considered alternative pilot programs with fewer such exclusions. Firms that are entirely or partially excluded that would otherwise participate in the proposed pilot program do not incur a cost relative to the baseline, but they fail to receive the benefits of alternative programs in which they would choose to participate. Restrictions that exclude these firms not only limit the benefits of the pilot program but also limit the potential learnings from the proposed program. As a result, the same restrictions may ultimately need to be carried over into any ongoing program of risk-based examinations. The exclusion of such firms, however, should reduce any risk of customer harm from not having on-site inspections.¹¹⁷

In addition, FINRA considered the merits of adapting other requirements similar to those FINRA has proposed in the 2023 RSL Rule Filing.¹¹⁸ In particular, the 2023

¹¹⁷ See Zachary T. Kowaleski, Andrew G. Sutherland & Felix W. Vetter, Supervisor Influence on Employee Financial Misconduct (Working Paper, July 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3646617. This paper presents evidence that could be interpreted as supportive of the exclusions based on misconduct and lack of experience.

¹¹⁸ See note 110, *supra*. FINRA previously filed a similar proposed rule change with the SEC to adopt proposed Rule 3110.19, which FINRA withdrew on March 29,

RSL Rule Filing is proposing to impose limitations on the offices or locations that may be designated as an RSL. One limitation is that an office or location at which an associated person has less than one year of supervisory experience with the firm or is functioning as a principal for a limited period in accordance with Rule 1210.04 (Requirements for Registered Persons Functioning as Principals for a Limited Period) would be ineligible for RSL designation. FINRA believes that adding these limitations to this proposed rule change would not be appropriate because the presence of even one such associated person at an office or location would disqualify an office or location of any size from participating in the proposed pilot program. FINRA believes that imposing these limitations in this proposed rule change would adversely impact the potential population of pilot program participants, which would then negatively impact FINRA's data and information collection efforts to gauge the effectiveness of remote inspections in a hybrid work environment. Moreover, FINRA believes that this proposed rule change provides for the appropriate controls for participation in the proposed pilot program.

Finally, FINRA considered different levels of detail for the data reporting requirement. FINRA has tried to carefully balance the reporting burden for firms with the need for enough information to make statistically valid comparisons. Nevertheless, depending on the number and type of pilot program participants, interpretation of the results will be subject to caveats.

2022. See <https://www.finra.org/sites/default/files/2023-03/sr-finra-2022-019-withdrawal.pdf>.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The SEC published the 2022 Remote Inspections Pilot Program Rule Filing for comment and as of the end of the comment period on September 6, 2022, the SEC had received 24 comment letters, then subsequently received four more new comment letters.¹¹⁹ On November 10, 2022, the Commission instituted proceedings to determine whether to approve or disapprove the 2022 Remote Inspections Pilot Program Rule Filing ("Order"), and the SEC received five comments letters in response to the Order.¹²⁰ On December 15, 2022, FINRA filed Partial Amendment No. 1 and responded to the comment letters.¹²¹ On December 22, 2022, the SEC published the partial amendment to the 2022 Remote Inspections Pilot Program Rule Filing for comment and as of the end of the comment period on January 12, 2023, the SEC had received four comment letters.¹²² On April 11, 2023, FINRA withdrew the 2022 Remote Inspections Pilot Program Rule Filing to consider whether more safeguards and clarifications to the filing would be appropriate in response to concerns raised by commenters. While the proposed rule change retains many of the terms set forth in the 2022 Remote Inspections Pilot Program Rule Filing, the proposed rule change makes some adjustments, which are discussed in detail above under Item II.A.1(IV).

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2023-007 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2023-007. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The

¹¹⁹ See note 52, supra.

¹²⁰ See Securities Exchange Act Release No. 96297 (November 10, 2022), 87 FR 68774 (November 16, 2022) (Order Instituting Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2022-021).

¹²¹ See Exhibits 2b and 2c.

¹²² See note 52, supra.

Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2023-007 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹²³

Jill M. Peterson
Assistant Secretary

¹²³ 17 CFR 200.30-3(a)(12).

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 96

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. * SR 2022 - * 021

Amendment No. (req. for Amendments *)

Filing by Financial Industry Regulatory Authority

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial *

☒

Amendment *

☐

Withdrawal

☐

Section 19(b)(2) *

☒

Section 19(b)(3)(A) *

☐

Section 19(b)(3)(B) *

☐

Pilot

☐Extension of Time Period for
Commission Action *☐

Date Expires *

Rule

☐

19b-4(f)(1)

☐

19b-4(f)(4)

☐

19b-4(f)(2)

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19b-4(f)(5)

☐

19b-4(f)(3)

☐

19b-4(f)(6)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) *

☐

Section 806(e)(2) *

☐Security-Based Swap Submission pursuant to the
Securities Exchange Act of 1934

Section 3C(b)(2) *

☐

Exhibit 2 Sent As Paper Document

☐

Exhibit 3 Sent As Paper Document

☐**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision)

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name *

Sarah

Last Name *

Kwak

Title *

Associate General Counsel

E-mail *

sarah.kwak@finra.org

Telephone *

(202) 728-8471

Fax

Signature

Pursuant to the requirements of the Securities Exchange of 1934, Financial Industry Regulatory Authority has duty caused this filing to be signed on its behalf by the undersigned thereunto duty authorized.

Date

07/28/2022

(Title *)

By

Kosha Dalal

(Name *)

Vice President and Associate General Counsel

NOTE: Clicking the signature block at right will initiate digitally signing the form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Kosha Dalal

Digitally signed by Kosha
Dalal
Date: 2022.07.28 12:32:25
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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information *

Add Remove View

FINRA-2022-021 19b-4.docx

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

Add Remove View

FINRA-2022-021 Exhibit 1.docx

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A - Notice of Proposed Rule Change, Security-Based Swap Submission, or Advanced Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2- Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

☐

Exhibit Sent As Paper Document

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

☐

Exhibit Sent As Paper Document

Exhibit 4 - Marked Copies

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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FINRA-2022-021 Exhibit 5.docx

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”),¹ the Financial Industry Regulatory Authority, Inc. (“FINRA”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend FINRA Rule 3110 (Supervision) to adopt a voluntary, three-year remote inspection 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 branch offices and locations remotely without an on-site visit to such office or location, subject to specified terms.

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice.

¹ 15 U.S.C. 78s(b)(1).

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

Beginning many years ago, SEC staff and FINRA have interpreted FINRA rules to require member firms to conduct on-site inspections of branch offices and unregistered offices (i.e., non-branch locations) in accordance with the periodic schedule described under Rule 3110(c)(1).² Over the years, widespread advancements in technology and communications in the financial industry have significantly changed the way in which members and their associated persons conduct their business and communicate, including the practices that formed the original bases for an on-site inspection requirement. For example, making and preserving records electronically have increasingly become the norm and the preferred recordkeeping medium rather than paper (e.g., cloud based storage); communications between and among members, their associated persons and customers commonly take place through email, video or some other electronic means (e.g., WebEx, Zoom) that can be monitored electronically by firms; processes for opening customer accounts and placing trades are moving to online platforms; and customer funds and securities are frequently and increasingly transmitted electronically rather than in

² See SEC National Examination Risk Alert, Volume I, Issue 2 (November 30, 2011), <https://www.sec.gov/about/offices/ocie/riskalert-bdbranchinspections.pdf> and Regulatory Notice 11-54 (November 2011) (“Notice 11-54”) (joint SEC and FINRA guidance stating, a “broker-dealer must conduct on-site inspections of each of its office locations; [Office of Supervisory Jurisdiction (“OSJs”)] and non-OSJ branches that supervise non-branch locations at least annually, all non-supervising branch offices at least every three years; and non-branch offices periodically.”). See also SEC Division of Market Regulation, Staff Legal Bulletin No. 17: Remote Office Supervision (March 19, 2004) (“SLB 17”) (stating, in part, that broker-dealers that conduct business through geographically dispersed offices have not adequately discharged their supervisory obligations where there are no on-site routine or “for cause” inspections of those offices), <https://www.sec.gov/interp/leg/mrslb17.htm>.

physical form (e.g., Venmo, Zelle). Relatedly, the challenges in supervising associated persons who work in outlying offices or locations have been mitigated over the years with the prevalent and effective use of technology. For example, supervisory reviews for outside business activities of associated persons are often conducted through general internet searches, including social media and online public records, and by reviewing electronic communications and customer fund transfers. Similarly, reviews of correspondence, customer funds and securities, and order flows are accomplished primarily through the use of electronic tracking programs or applications.

FINRA notes that firms are turning to new and innovative regulatory tools such as artificial intelligence, natural language processing, and robotics process automation, among others, to strengthen their compliance programs.³ More recently, firms have questioned the benefits of the on-site inspection requirement for all offices, particularly in light of these significant technological advances that have enhanced the effectiveness of a firm's overall and ongoing supervision and monitoring of the activities occurring at their offices (registered and unregistered).⁴

³ See generally FINRA White Paper, Technology Based Innovations for Regulatory Compliance ("RegTech") on the Securities Industry (September 2018), https://www.finra.org/sites/default/files/2018_RegTech_Report.pdf.

⁴ Some firms have indicated, for example, that technology has enhanced real time monitoring of their associated persons by providing the ability for firm compliance personnel to join, on an ad hoc basis, digital or virtual meetings occurring between the firm's associated persons and customers. Firms have also indicated that technology has allowed them to impose various restrictions or limitations on associated persons, such as the ability to print firm records from remote locations using a firm-issued laptop, and only accepting electronic payments from customers.

The COVID-19 pandemic has accelerated the use of a wide variety of compliance and workplace technology as many government and private employers, including member firms, were driven to adopt a broad remote work environment by quickly moving their employees out of their usual office setting to an alternative worksite such as a private residence. Insights obtained from member firms and other industry representatives through various pandemic-related initiatives and other industry outreach have led FINRA to carefully consider whether some processes and rules, including the manner in which a firm may satisfy its Rule 3110(c) obligations, should be modernized.⁵ Technological improvements and developments in regulatory compliance have provided more tools than before to create more effective and efficient compliance programs. To that end, FINRA believes that regulatory models should evolve to benefit from the availability and use of effective technology tools. With the confluence of advances in

⁵ See generally FINRA’s Key Topic: COVID-19/Coronavirus (referencing, among other things, Frequency Asked Questions, temporary amendments to FINRA rules, and Regulatory Notices such as Regulatory Notices 20-08 (March 2020) (“Notice 20-08”), regarding pandemic-related business continuity planning, guidance and regulatory relief to member firms from some requirements, including the temporary suspension of the requirement to maintain updated information on Form U4 (Uniform Application for Securities Industry Registration or Transfer) and submit Form BR (Uniform Branch Office Registration Form) for temporary locations; 20-16 (May 2020) (“Notice 20-16”), describing practices implemented by firms to transition to, and supervise in, remote work environment during the COVID-19 pandemic; 20-42 (December 2020) (“Notice 20-42”), seeking comment on lessons from the pandemic; and 21-44 (December 2021) (“Notice 21-44”), regarding business continuity planning and lessons from the pandemic, <https://www.finra.org/rules-guidance/key-topics/covid-19>. See also SEC Press Release 2022-112 (June 22, 2022) for the Spring 2022 Regulatory Agenda (quoting SEC Chair Gary Gensler: “When I think about the SEC’s agenda, I’m driven by two public policy goals: continuing to drive efficiency in our capital markets and modernizing our rules for today’s economy and technologies.”), https://www.sec.gov/news/press-release/2022-112?utm_medium=email&utm_source=govdelivery.

compliance technology and the permanent shift to a remote or hybrid work environment, made more pronounced by the pandemic, FINRA believes that the optimal use of on-site inspections deserves further consideration.

To address the operational challenges in conducting on-site inspections during the pandemic, FINRA adopted temporary Rule 3110.17, effective since November 2020, to provide member firms the option to conduct inspections of their branch offices and non-branch locations remotely, subject to specified terms therein.⁶ Although uncertainty about the pandemic remains, firms are beginning to look ahead at the post-pandemic changes to their workplaces, including more flexible work hours and hybrid work models—working sometimes on-site in a conventional office setting and other times remotely in a private residence or other alternative worksite. As such, FINRA believes now is the time to assess possible longer-term rule changes and is, therefore, proposing a voluntary, three-year remote inspections pilot program. This program would provide FINRA with specific, structured data from member firm pilot participants to evaluate their experiences—positive and negative—and inspection findings. This data would enable FINRA to systematically assess the overall impact on firms’ supervisory systems, which has not been feasible with information drawn from the pandemic-related office shutdowns. Moreover, the proposed pilot program would maintain effective supervision by firms through firms’ ongoing supervisory obligations under Rule 3110, and the proposed limitations on the firms and locations that would be eligible to participate in the proposed pilot program.

⁶ See Securities Exchange Act Release No. 90454 (November 18, 2020), 85 FR 75097 (November 24, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-040).

The Inspection Requirement Under Rule 3110

The responsibility of firms to supervise their associated persons is a critical component of broker-dealer regulation.⁷ Member firms must supervise all of their associated persons, regardless of their location, compensation or employment arrangement, or registration status.⁸ Rule 3110 requires a member, regardless of size or type, to have a supervisory system for the activities of its associated persons that is reasonably designed to achieve compliance with the applicable securities laws and regulations and FINRA rules, and sets forth the minimum requirements for such supervisory system.⁹

As part of that supervisory system, Rule 3110(c) requires a member to review, at least annually, the businesses in which it engages for purposes of detecting and

⁷ See SLB 17, supra note 2; see also Notice 11-54 and Notice to Members 98-38 (May 1998) (“Notice 98-38”).

⁸ This obligation is derived from Sections 15(b)(4)(E) and 15(b)(6)(A) of the Exchange Act. Section 15(b)(4)(E) provides that the “Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer if it finds . . . that such broker or dealer . . . or any person associated with such broker or dealer . . . has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any person of any provision of the Securities Act of 1933, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, [the Securities Exchange Act of 1934], the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, or has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision.” 15 U.S.C. 78o(b)(4)(E). Section 15(b)(6)(A)(i) parallels Section 15(b)(4)(E) and provides for the imposition of sanctions against persons associated with a broker or dealer that violates those statutes, rules and regulations enumerated in Section 15(b)(4)(E) and other specified subparagraphs under Section 15(b)(4). 15 U.S.C. 78o(b)(6)(A).

⁹ See Rule 3110(a).

preventing violations of, and achieving compliance with, applicable securities laws and regulations. The review must include periodic inspections of each office and examination of customer accounts to detect and prevent irregularities and abuses. The inspection requirement is a longstanding supervisory obligation that in its early form had addressed the inspection requirement for an OSJ only.¹⁰ FINRA expanded the inspection requirement to cover branch offices out of concern for the potential regulatory problems that could emerge when a registered person, situated in an office other than an OSJ, was engaging in securities-related activities without the direct oversight of qualified supervisory personnel and without an annual inspection.¹¹

Currently, Rule 3110(c) sets forth three main requirements for conducting internal inspections. First, an inspection of an office or location must occur on a designated frequency. The periodicity of the required inspection varies depending on the classification of the location or the nature of the activities that take place: OSJs and supervisory branch offices must be inspected at least annually;¹² non-supervisory branch

¹⁰ Article III, Section 27(d) of the NASD Rules of Fair Practice had provided: “Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses and at least an annual inspection of each office of supervisory jurisdiction.” See Notice to Members 87-41 (June 1987) (setting forth the then existing rule text for specified parts of Article III, Section 27 (Supervision) of the NASD Rules of Fair Practice as part of a proposal to amend the OSJ and branch office definitions).

¹¹ See Securities Exchange Act Release No. 26177 (October 13, 1988), 53 FR 41008 (October 19, 1988) (Order Approving File No. SR-NASD-88-31). See also Notice to Members 88-84 (November 1988) and Notice to Members 89-34 (April 1989).

¹² See Rule 3110(c)(1)(A).

offices, at least every three years;¹³ and non-branch locations, on a periodic schedule, presumed to be at least every three years.¹⁴ Second, a member must retain a written record of the date upon which each review and inspection occurred, reduce a location's inspection to a written report and keep each inspection report on file either for a minimum of three years or, if the location's inspection schedule is longer than three years, until the next inspection report has been written.¹⁵ If applicable to the location being inspected, the inspection report must include the testing and verification of the member's policies and procedures, including supervisory policies and procedures, in specified areas.¹⁶ Third, to prevent compromising the effectiveness of inspections due to conflicts of interest, the rule requires a member to ensure that the person conducting the inspection is not an associated person assigned to the location or is not directly or

¹³ See Rule 3110(c)(1)(B).

¹⁴ See Rules 3110(c)(1)(C) and 3110.13 (General Presumption of Three-Year Limit for Periodic Inspection Schedules).

¹⁵ See Rule 3110(c)(2).

¹⁶ See Rule 3110(c)(2)(A) (providing that the inspection report must include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures for: (1) safeguarding of customer funds and securities; (2) maintaining books and records; (3) supervision of supervisory personnel; (4) transmittals of funds from customers to third party accounts, from customer accounts to outside entities, from customer accounts to locations other than a customer's primary residence, and between customers and registered representatives, including the hand delivery of checks; and (5) changes of customer account information, including address and investment objectives changes, and validation of such changes).

indirectly supervised by, or otherwise reporting to, an associated person assigned to that location.¹⁷ All branch offices and non-branch location are subject to Rule 3110(c).

Further, Rule 3110.12 (Standards for Reasonable Review) sets out factors that constitute a reasonable review. This provision emphasizes establishing reasonable supervisory procedures and conducting reviews of locations, taking into consideration, among other things, the member's size, organizational structure, scope of business activities, number and location of the member's offices, the nature and complexity of the products and services offered by the member, the volume of business done, the number of associated persons assigned to a location, the disciplinary history of registered representatives or associated persons, and any indicators of irregularities or misconduct (i.e., "red flags").¹⁸ The provision further states that the procedures established and

¹⁷ Rule 3110(c)(3) provides a limited exception from this requirement if a firm determines compliance is not possible either because of the firm's size or its business model. Rule 3110.14 (Exception to Persons Prohibited from Conducting Inspections) reflects FINRA's expectation that a firm generally will rely on the exception in instances where the firm has only one office or has a business model where small or single-person offices report directly to an OSJ manager who is also considered the offices' branch office manager. However, these situations are non-exclusive, and a firm may still rely on the exception in other instances where it cannot comply because of its size or business model, provided the firm complies with the documentation requirements under the rule.

¹⁸ Red flags that suggest the existence or occurrence of violations, prompting an unannounced visit, may include: customer complaints; a large number of elderly customers; a concentration in highly illiquid or risky investments; an unexplained increase or change in the types of investments or trading concentration that a representative is recommending or trading; an unexpected improvement in a representative's production, lifestyle, or wealth; questionable or frequent transfers of cash or securities between customer or third party accounts, or to or from the representative; a representative that serves as a power of attorney, trustee or in a similar capacity for a customer or has discretionary control over a customer's account(s); representative with disciplinary records; customer investments in one or a few securities or class of securities that is inconsistent with firm policies related to such investments; churning; trading that is inconsistent with customer

reviews conducted must provide that the quality of supervision at remote (i.e., geographically dispersed) locations is sufficient to ensure compliance with applicable securities laws and regulations and with FINRA rules, and that members must be especially diligent with respect to a non-branch location where a registered representative engages in securities activities. This provision incorporates guidance FINRA has previously issued about supervising associated persons working in geographically dispersed offices.¹⁹

In 2004, the SEC staff similarly provided guidance on supervision principles.²⁰ At that time, the SEC staff noted that small, geographically scattered offices presented supervisory challenges when they were not subject to on-site supervision. The SEC staff observed that an office's geographic distance from supervisory personnel could make it easier for registered persons and other employees to carry out and conceal violative conduct. This general observation was derived from SEC enforcement cases finding that firms had inadequately supervised their associated persons working in small, geographically distant offices due to the failure of their supervisory mechanisms to detect and prevent misconduct. Citing technology available at the time, the guidance emphasized that an effective supervisory system for geographically dispersed offices uses a combination of on-site and off-site monitoring; it specifically said that "[c]entralized

objectives; numerous trade corrections, extensions, liquidations; or significant switching activity of mutual funds or variable products held for short time periods. See SLB 17, supra note 2; see also Notice 98-38 and Notice to Members 99-45 (June 1999) ("Notice 99-45").

¹⁹ See, e.g., Notices 98-38 and 99-45.

²⁰ See SLB 17, supra note 2.

technology to monitor the trading and handling of funds in remote office accounts, as well as the use of personal computers, helps detect misappropriation of customer funds, selling away, and unauthorized trading, among other things[.]”²¹ The guidance supported both routine or “for cause” on-site inspections, and encouraged unannounced inspections either on a random basis or where there are red flags about unusual activity at those offices. Further, as noted above, in the past both the SEC staff and FINRA have expressed the view that inspections must have an on-site component, reflecting how office inspections have been historically conducted.²²

Since the time these in-person guidelines were expressed, developments in technology have enhanced firms’ overall and ongoing supervision and monitoring of the activities occurring at branch offices and non-branch locations. In response to these developments, member firms have questioned the historical expectation that firms satisfy the inspection component of Rule 3110(c) solely in a physical, on-site manner.

The 2017 Proposal to Allow Remote Inspections and the Impact from the Pandemic

Even prior to the pandemic, in 2017, FINRA considered a proposal to give firms the option of satisfying the inspection requirement remotely for “qualifying offices” that

²¹ See SLB 17, supra note 2.

²² See note 2, supra.

met specified criteria.²³ However, the COVID-19 pandemic, declared in early 2020,²⁴ significantly changed the industry's standard business operations, forcing member firms to adapt to a full remote work environment and implement remote supervisory practices.²⁵ FINRA deferred the 2017 Proposal in light of the pressing need to address significant operational disruptions to the securities industry, regulators, impacted member firms, investors and other stakeholders. During this exigent period, FINRA responded to numerous issues and questions that urgently arose.²⁶ Following up on these actions, FINRA published Notice 20-42 to gain a broader understanding of member firm experiences during the pandemic. This notice sought feedback from firms about their experiences in a range of areas, including how member firms' operations and business models changed during the public health crisis and how they might further evolve as the pandemic persisted. Other initiatives included sharing general practices of firms in transitioning and supervising in the remote work environment, and providing temporary

²³ See Regulatory Notice 17-38 (November 2017) ("2017 Proposal"). FINRA had requested comment on a proposed amendment to Rule 3110 to allow remote inspections of "qualifying offices" that met specified criteria, in lieu of on-site inspections of such offices and locations. In general, many of the comment letters FINRA had received expressed support for the underlying concept of remote inspections and offered recommendations on specific criteria to broaden the potential population of qualifying offices.

²⁴ See Centers for Disease Control and Prevention ("CDC"), International Classification of Diseases, Tenth Revision, Clinical Modification (ICD-10-CM) (Effective March 18, 2020), <https://www.cdc.gov/nchs/data/icd/Announcement-New-ICD-code-for-coronavirus-3-18-2020.pdf>. See also WHO Director-General, Opening Remarks at the Media Briefing on COVID-19 (March 11, 2020), <https://www.who.int/director-general/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020>.

²⁵ See generally Regulatory Notice 20-16 (May 2020).

²⁶ See note 5, supra.

relief to member firms from specified FINRA rules and requirements.²⁷ In particular, to give firms an opportunity to better manage their operational challenges and redirect resources attendant to fulfilling their inspection obligations, FINRA provided temporary relief to member firms pertaining to the in-person inspection aspect of Rule 3110(c).²⁸

Temporary Amendments to the Inspection Requirement Under Rule 3110(c)

At the outset of the pandemic in the United States, many states issued stay-at-home orders and imposed restrictions on businesses, social activities, and travel in hopes of slowing the spread of COVID-19.²⁹ In response, many government and private employers, including member firms, closed their offices and moved their employees to alternative worksites (e.g., an employee's residence). These operational changes made it impracticable for member firms to conduct the on-site inspection component of Rule 3110(c) at most locations for that year because of limitations on travel to geographically dispersed OSJs, branch offices, and non-branch locations. In response to the logistical challenges, FINRA extended the time by which member firms were required to complete their calendar year 2020 inspection obligations under Rule 3110(c) to March 31, 2021 with the expectation that the extension did not relieve firms from the on-site portion of

²⁷ Some temporary amendments to other FINRA rules still remain in effect. See Securities Exchange Act Release No. 95281 (July 14, 2022), 87 FR 43335 (July 20, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-018) (extending the expiration date of temporary amendments set forth in SR-FINRA-2020-015 and SR-FINRA-2020-027).

²⁸ See Rules 3110.16 and 3110.17.

²⁹ See note 6, supra, 85 FR 75097, 75098 n.10.

the inspections of their offices and locations.³⁰ However, health and safety concerns remained unabated and with many restrictive measures still in place as calendar year 2020 was ending, FINRA adopted Rule 3110.17 to provide member firms the option, subject to specified requirements under the supplementary material, to complete remotely their calendar year inspection obligations without an on-site visit to the office or location.³¹ This relief was repeatedly extended until the end of 2022.³² Rule 3110.17 will automatically sunset on December 31, 2022.³³

Through comments to the 2017 Proposal, Notice 20-42, the various temporary amendments to Rule 3110, and other engagement with industry representatives, firms have highlighted that Rule 3110(c) was adopted well before the prevalence of modern technology, including laptops, mobile devices, video conferencing capabilities, electronic storage and electronic surveillance, at a time when on-site inspections were the only conceivable way firms could inspect and review activities occurring in outlying offices and locations. The advent of new and developing technologies has enhanced the effectiveness of a firm's ongoing supervision and monitoring of associated persons working from dispersed branch offices and non-branch locations. In addition, firms have

³⁰ See Securities Exchange Act Release No. 89188 (June 30, 2020), 85 FR 40713 (July 7, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-019).

³¹ See note 6, supra.

³² See Securities Exchange Act Release No. 93002 (September 15, 2021), 86 FR 52508 (September 21, 2021) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2021-023); and Securities Exchange Act Release No. 94018 (January 20, 2022), 87 FR 4072 (January 26, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-001).

³³ See note 32, supra.

noted that in practice, those technological advances allow a large portion of inspection work to be conducted electronically, prior to any on-site visit to the office and location, and that in general, on-site inspections of many offices and locations are one component of a firm's overall supervisory system of associated persons and offices, and as such are no longer an efficient and effective use of limited firm resources.³⁴

However, Rule 3110.17 was adopted in the midst of the pandemic, when many offices and locations were closed, and employees carried out their responsibilities from alternative worksites. FINRA recognizes that the pandemic has changed the conventional thinking on where work is conducted and this shift in the workforce landscape will unlikely revert to the model that existed pre-pandemic. As noted above, FINRA believes that adopting a voluntary, three-year remote inspection pilot program, under terms based largely on Rule 3110.17, but with significant safeguards, would allow FINRA the time to collect specified data from member firm pilot participants to evaluate their experiences

³⁴ In response to FINRA's proposed rule changes associated with Rule 3110.17, one commenter made similar points about the physical, on-site piece of the inspection process. This commenter stated that pre-pandemic, an on-site inspection of a branch office typically consisted of reviewing the lobby area of the office, the back office (to review safe contents, sales literature, daily operations logs containing account applications), signage, and the physical security of the office. See Letter from Carrie L. Chelko, Chief Compliance Officer, Fidelity Brokerage Services LLC ("Fidelity Brokerage") & Norman L. Ashkenas, Chief Compliance Officer, National Financial Services LLC ("NFS") and Fidelity Distributors Company LLC ("Fidelity Distributors"), to Vanessa Countryman, Secretary, SEC, dated July 28, 2020, in response to Securities Exchange Act Release No. 89188 (June 30, 2020), 86 FR 40713 (July 7, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-019) and Letter from Gail Merken, Chief Compliance Officer, Fidelity Brokerage, Janet Dyer, Chief Compliance Officer, NFS & John McGinty, Chief Compliance Officer, Fidelity Distributors, to Vanessa Countryman, Secretary, SEC, dated February 16, 2022, in response to Securities Exchange Act Release No. 94018 (January 20, 2022), 87 FR 4072 (January 26, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-001).

and inspection findings in a uniform, comparable manner in the context of the emerging hybrid work model. FINRA anticipates that the proposed pilot program will provide broader systemized information to supplement the information obtained through the FINRA examination process in an environment where offices and locations were closed. The information firms will be required to produce as a pilot program participant will help FINRA more accurately assess the overall impacts on firms' supervisory systems to inform FINRA's application of supervisory requirements to the new work environment, including potentially broader reliance on remote inspections.

Proposed Voluntary, Three-Year Pilot Program for Remote Inspections

With Rule 3110.17 operational since November 2020, and the widespread availability and use of technology described above, regulators are being challenged to consider whether on-site inspections by firms should be a necessity and if they continue to be an efficient and effective method for supervising and monitoring associated persons and offices as part of a firm's overall supervisory system.

As FINRA emphasized in the proposed rule change to adopt Rule 3110.17, the responsibility of firms to supervise their associated persons on a day-to-day basis is a critical component of broker-dealer regulation.³⁵ The inspection requirement in Rule 3110(c) is just one element of a reasonably designed supervisory system. FINRA believes that a pilot period of risk-based on-site supervision is consistent with firms' core responsibility, as set forth in Rule 3110, to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. The

³⁵ See note 6, supra.

proposed pilot program would build largely on the terms of Rule 3110.17, but would be enhanced in several ways, including notably targeted exclusions from participation in the program for higher risk member firms, and offices or locations. In addition, the proposed pilot program would require a firm conduct a risk assessment for each office or location that is selected to be inspected remotely, documented with the factors considered.

Finally, the proposed pilot program would require a firm to establish and maintain written supervisory procedures to account for the risk assessment and sets forth the scope of the program.

A. Scope of Pilot (Proposed Rule 3110.18(a))

Under proposed Rule 3110.18(a), the proposed pilot program would apply to the required inspections of OSJs, branch offices, and non-branch locations under the applicable provisions under Rule 3110(c)(1) for a pilot period of three years starting on the effective date, and expiring on a date that is three years after the effective date. If the proposed pilot program is not extended or Rule 3110.18, as may be amended, is not approved as permanent by the SEC, the proposed supplementary material will automatically sunset on a date that is three years after the effective date. In addition, proposed Rule 3110.18(a) would expressly state that members would not be able to avail themselves of the proposed pilot program after it expires.

B. Use of Remote Inspections (Proposed Rule 3110.18(b))

1. Risk-Based Approach; Risk Assessment (Proposed Rule 3110.18(b)(1))

As described above, Rule 3110(c)(1) provides that an inspection of an office or location must occur on a designated frequency, and the periodicity of the required inspection varies depending on the classification of the location as an OSJ, branch office

or non-branch location. Subject to proposed Rule 3110.18(b)(2) as described below, proposed Rule 3110.18(b)(1) would provide that a member firm may elect to conduct the applicable inspection of an office or location during the pilot period remotely, without necessarily an on-site visit for the office or location, when the member reasonably determines that the purposes of the rule can be accomplished by conducting such required inspection remotely.³⁶ Proposed Rule 3110.18(b)(1) would also provide that prior to electing a remote inspection for an office or location, rather than an on-site inspection, the firm must develop a reasonable risk-based approach to using remote inspections and conduct and document a risk assessment for that office or location. The assessment must document the factors considered, including the factors set forth in Rule 3110.12, and must take into account any higher risk activities that take place or higher risk associated persons that are assigned to that location. FINRA expects that higher risk factors at a particular location would cause a firm to conduct on-site inspections of such location. Further, under the proposed supplementary material, a member that is not eligible to conduct remote inspections under proposed Rule 3110.18(b)(2) must conduct an on-site inspection of that office or location on the required cycle. Finally, notwithstanding the pilot program, a member would remain subject to the other requirements and limitations of Rule 3110(c).³⁷

³⁶ As described further below, a member firm that elects to participate in the proposed pilot program would be subject to the requirements of proposed Rule 3110.18 for a Pilot Year. See proposed Rule 3110.18(g).

³⁷ For example, as currently required with any physical, on-site inspection, a member would be required to reduce the remote inspection to a written report and satisfy the content and record retention requirements of such report as described in Rule 3110(c)(2). Similarly, a member would remain subject to Rule 3110(c)(3)'s general prohibition against an associated person from conducting a

2. Ineligible Member Firms, and Offices or Locations (Proposed Rule 3110.18(b)(2))

FINRA is proposing to exclude some member firms or their offices or locations from participating in the proposed pilot program. The proposed categories of ineligibility are events or activities of a member firm or its associated persons that FINRA believes are more likely to raise investor protection concerns based on the firm's or an associated person's record of specified regulatory or disciplinary events.

Under proposed Rule 3110.18(b)(2)(A), a member firm would be ineligible to conduct remote inspections of any of its offices if any time during the period of the proposed pilot program, the member is or becomes: (1) designated as a Restricted Firm under Rule 4111³⁸ (proposed Rule 3110.18(b)(2)(A)(i)); or (2) designated as a Taping Firm under Rule 3170³⁹ (proposed Rule 3110.18(b)(2)(A)(ii). These rules expressly

location's inspection if the person either is assigned to that location or is directly or indirectly supervised by, or otherwise reports to, someone assigned to that location. Rule 3110(c)(3) provides a limited exception from this general prohibition for specified circumstances (e.g., the member has a business model where a small or single-person offices report directly to an OSJ manager who is also considered the offices' branch office manager) by requiring a member to document in the inspection report both the factors the member used to make the determination that it could not comply with the general prohibition and how the inspection otherwise complies with Rule 3110(c)(1).

³⁸ In general, Rule 4111 (Restricted Firm Obligations) requires member firms that are identified as "Restricted Firms" to deposit cash or qualified securities in a segregated, restricted account; adhere to specified conditions or restrictions; or comply with a combination of such obligations. See generally Regulatory Notice 21-34 (September 2021) (announcing FINRA's adoption of rules to address firms with a significant history of misconduct).

³⁹ In general, Rule 3170 (Tape Recording of Registered Persons by Certain Firms) requires a member firm to establish, enforce and maintain special written procedures supervising the telemarketing activities of all of its registered persons, including the tape recording of conversations, if the firm has hired more than a specified percentage of registered persons from firms that meet FINRA Rule

address firms that pose higher risks, and for that reason, would be ineligible to participate in the proposed pilot program.

In addition, under proposed Rule 3110.18(b)(2)(B), a member firm's office or location would be ineligible for a remote inspection if at any time during the period of the proposed pilot program, an associated person at such office or location is or becomes: (1) subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or state regulatory agency (proposed Rule 3110.18(b)(2)(B)(i)); (2) statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a mandatory heightened supervisory plan under proposed Rule 3110.18(b)(2)(B)(i) or otherwise as a condition to approval or permission for such association (proposed Rule 3110.18(b)(2)(B)(ii)); (3) subject to Rule 1017(a)(7)⁴⁰ as a result of one or more associated persons at such location (proposed Rule 3110.18(b)(2)(B)(iii)); or (4) one or more associated persons at such location has an event in the prior three years that required a "yes" response to any item in Questions 14A(1)(a)

3170's definition of "disciplined firm." See generally Regulatory Notice 14-10 (March 2014) (announcing FINRA's adoption of consolidated rules governing supervision).

⁴⁰ In general, Rule 1017(a)(7) require a member firm to file a CMA when a natural person seeking to become an owner, control person, principal or registered person of the member firm has, in the prior five years, one or more defined "final criminal matters" or two or more "specified risk events" unless the member firm has submitted a written request to FINRA seeking a materiality consultation for the contemplated activity. Rule 1017(a)(7) applies whether the person is seeking to become an owner, control person, principal or registered person at the person's current member firm or at a new member firm. See generally Regulatory Notice 21-09 (March 2021) (announcing FINRA's adoption of rules to address brokers with a significant history of misconduct).

and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4⁴¹ (proposed Rule 3110.18(b)(2)(B)(iv)). FINRA believes that the imposition of a mandatory heightened supervisory plan, a statutorily disqualification, a Rule 1017(a)(7) review due to significant misconduct, or the existence of specified disclosures on Form U4 pertaining to criminal convictions and final regulatory action are indicia of increased risk to investors at some office or locations, such that they should not be eligible for remote inspections in accordance with the proposed pilot program.

A member firm or an office or location subject to one of the categorical restrictions would not be eligible for remote inspections, even if the firm's risk assessment concludes that a remote inspection would be appropriate. A member firm would be required to conduct an on-site inspection of that office or location on the required cycle. FINRA believes the proposed list of ineligibility categories is appropriately derived from existing rule-based criteria that are part of processes to identify firms that may pose greater concern (e.g., Rules 4111 and 3170) or associated persons that may pose greater concerns due to the nature of disclosures of regulatory or disciplinary events on the uniform registration forms. FINRA believes that these objective categorical restrictions will provide safeguards that will help ensure that firms maintain effective supervisory procedures during the pilot period.

⁴¹ Form U4's Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a) elicit reporting of criminal convictions, and Questions 14C, 14D, and 14E pertain to regulatory action disclosures.

C. Written Supervisory Procedures for Remote Inspections (Proposed Rule 3110.18(c))

As part of an effective supervisory system tailored specifically to the member firm's business and the activities of all its associated persons, a member must establish and maintain written procedures.⁴² Paragraph (1) (General Requirements) under Rule 3110(b) (Written Procedures) provides that a member must establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

Currently, Rule 3110.17(b) expressly provides that consistent with a member's obligation under Rule 3110(b)(1), a member that elects to conduct each of its inspections in the specified calendar years remotely must amend or supplement its written supervisory procedures to provide for remote inspections that are reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with applicable FINRA rules. In addition, under Rule 3110.17(b), reasonably designed procedures for conducting remote inspection of offices or locations should include, among other things, a description of the methodology, including technologies permitted by the member, that may be used to conduct remote inspections. Further, such procedures should include the use of other risk-based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and

⁴² See Rule 3110(a)(1); see generally Notice 99-45 and Regulatory Notice 18-15 (April 2018).

regulations, and of applicable FINRA rules.⁴³ To underscore the importance of Rule 3110(b)(1) in the context of the proposed pilot program, FINRA is proposing to add to the elements currently described under Rule 3110.17(b) an express provision that the firm must adopt written supervisory procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. In addition, a firm's written supervisory procedures should also include the factors considered in the risk assessment made for each applicable office or location pursuant to proposed Rule 3110.18(b).

D. Effective Supervisory System (Proposed Rule 3110.18(d))

FINRA is proposing to retain the terms of Rule 3110.17(c), without substantive change, in proposed Rule 3110.18(d). Similar to Rule 3110.17(c), proposed Rule 3110.18(d) would expressly reiterate the principle that the requirement to conduct inspections of offices and locations is one part of the member's overall ongoing obligation to have an effective supervisory system, and therefore a member must continue with its reviews of the activities and functions occurring at all offices and locations whether or not the member conducts inspections remotely. In addition, proposed Rule 3110.18(d) would provide that a member's remote inspection of an office or location would be held to the same standards for review applicable to on-site

⁴³ Offices or locations that may present a higher risk profile would include, for example, those that have associated persons engaging in activities that involve handling customer funds or securities, maintaining books and records as described under applicable federal securities laws and FINRA rules, order execution or other activities that may be more susceptible to higher risks of operational or sales practice wrongdoing, or have associated persons assigned to an office or location who may be subject to additional or heightened supervisory procedures.

inspections as set forth under Rule 3110.12.⁴⁴ Further, proposed Rule 3110.18(d) would provide that where a member's remote inspection of an office or location identifies any indicators of irregularities or misconduct (i.e., "red flags"), the member may need to impose additional supervisory procedures for that office or location, or may need to provide for more frequent monitoring or oversight of that office or location, or both, including potentially a subsequent physical, on-site visit on an announced or unannounced basis.

E. Documentation Requirement (Proposed Rule 3110.18(e))

In general, Rule 3110(c)(2) imposes various documentation requirements for inspections, including maintaining a written record of the date upon which each inspection is conducted. Currently, Rule 3110.17(d) requires supplemental documentation by a member that avails itself of the remote inspection option. The member must maintain and preserve a centralized record for each of calendar years specified in the supplementary material that separately identifies: (1) all offices or locations that had inspections that were conducted remotely; and (2) any offices or locations that the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in Rule 3110.17(c). A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection. FINRA is proposing to incorporate, without substantive change, the terms of Rule 3110.17(d) in proposed Rule 3110.18(e), but make two clarifying changes. One change would be to reference that the centralize record must

⁴⁴ See note 18, supra and accompanying text.

be for each of the “pilot years” (as defined in proposed Rule 3110.18(h)), and the other change would be to clarify that a member’s documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection, including whether an on-site inspection was conducted at such office.

F. Data and Information Collection Requirement (Proposed Rule 3110.18(f))

1. Data and Information (Proposed Rule 3118.18(f)(1))

As noted above, Rule 3110.17 was adopted in the midst of the pandemic and operationalized in an environment in which many offices and locations were closed to the public. FINRA believes that the formalized, uniform collection of data is critical to allow FINRA to meaningfully assess the effectiveness of remote inspections to help shape potential permanent amendments to Rule 3110(c) that would optimize an inspection program in the evolving workplace environment. FINRA believes having a pilot program for remote inspections with appropriate conditions, limitations and documentation requirements in an environment that is resettling into a hybrid workplace model would provide a clearer picture of the strengths and weaknesses of remote inspections, without compromising investor protection. Proposed Rule 3110.18(f) would impose upon firms a data and information collection requirement as a condition for participating in the pilot program. On a frequency not to exceed quarterly, participating firms would be required to collect and produce to FINRA, in a manner and format determined by FINRA, data consisting of separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations, consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110, for several categories, including: (1)

the total number of inspections—on-site and remote—completed during each calendar quarter;⁴⁵ (2) the number of those office or locations in each calendar quarter that were subject to an on-site inspection because of a “finding” (defined under proposed Rule 3110.18(f) as an item that led to any remedial action or was listed on the member’s inspection report);⁴⁶ (3) the number of locations for which a remote inspection was conducted in the calendar quarter that identified a finding, the number of findings, and a list of the most significant findings;⁴⁷ and (4) the number of locations for which a on-site inspection was conducted in the calendar quarter that identified a finding, the number of findings, a list of the most significant findings.⁴⁸ In addition, firms would be required to provide FINRA their written supervisory procedures for remote inspections that account for: (1) escalating significant findings; new hires; supervising brokers with a significant history of misconduct; and outside business activities and “doing business as” (or DBA) designations.⁴⁹ Firms would be required to provide FINRA with a copy of these written supervisory procedures alongside the first delivery of the data points described above, and any subsequent amendments to such procedures for remote inspections.⁵⁰

⁴⁵ See proposed Rule 3110.18(f)(1)(A), (B) and (C).

⁴⁶ See proposed Rule 3110.18(f)(1)(D).

⁴⁷ See proposed Rule 3110.18(f)(1)(E).

⁴⁸ See proposed Rule 3110.18(f)(1)(F).

⁴⁹ See proposed Rule 3110.18(f)(1)(G)(i) through (iv).

⁵⁰ See proposed Rule 3110.18(f)(1)(G).

2. Additional Data and Information for Pilot Year 1 (Proposed Rule 3110.18(f)(2))

Proposed Rule 3110.18(f)(2) would address the additional data and information requirements for Pilot Year 1 (as defined under proposed Rule 3110.18(h)), if such year covers a period that is less than a full calendar year. In such case, a member that elects to participate in the proposed pilot program would be required to collect the following data and information and provide such data and information to FINRA (in a manner and format FINRA determines) no later than December 31 of such first Pilot Year. For items (1) through (3) below, a member would be required to provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110: (1) the number of locations with an inspection completed during the full calendar year of the first Pilot Year; (2) the number of locations in item (1) that were inspected remotely during the full calendar year of the first Pilot Year; and (3) the number of locations in item (1) that were inspected on-site during the full calendar year of the first Pilot Year. This additional data and information would provide FINRA the ability to capture, in the aggregate, complete inspection counts—total number of Rule 3110(c)(1) inspections (remote and on-site)—for the entire calendar year in addition to the more detailed data and information requirements under proposed Rule 3110.18(f)(1).

3. Written Policies and Procedures (Proposed Rule 3110.18(f)(3))

Proposed Rule 3110.18(f)(3) would also remind firms of the general requirement to establish, maintain and enforce written policies and procedures that are reasonably designed to comply with the data and information collection, and transmission requirements of the proposed pilot program.

4. Remote Inspections Pilot Program Participation (Proposed Rule 3110.18(g))

Proposed Rule 3110.18(g) would set forth the manner in which a firm would notify FINRA of the firm's election to participate in the proposed pilot program and to withdraw from it. The proposed rule would provide that FINRA may, in exceptional cases and where good cause is shown, waive the applicable timeframes described below for the required opt-in or opt-out notices.

Proposed Rule 3110.18(g) would require a firm, at least five calendar days before the beginning of such Pilot Year, to provide FINRA an "opt-in notice" in the manner and format determined by FINRA. By providing such opt-in notice to FINRA, the firm agrees to participate in the proposed pilot program for the duration of such Pilot Year and to comply with the requirements of Rule 3110.18.⁵¹ A firm that provides the opt-in notice for a Pilot Year would be automatically deemed to have elected and agreed to participate in the Remote Inspections Pilot Program for subsequent Pilot Years (i.e., Pilot Year 2, Pilot Year 3, and Pilot Year 4, if applicable) until the pilot program expires. Further, proposed Rule 3110.18(g) would describe the notice requirement for a firm to withdraw from the proposed pilot program. A firm would be required to provide FINRA with an "opt-out notice" at least five calendar days before the end of the then current Pilot Year.

By way of example, a firm that provides FINRA an opt-in notice on June 26 to join Pilot Year 1 that begins on July 1 would be automatically deemed to continue participating in Pilot Year 2 unless the firm provides FINRA the required opt-out notice

⁵¹ A firm that participates in a Pilot Year would be committed to complying with the terms of proposed Rule 3110.18 for that Pilot Year.

no later than December 26 of Pilot Year 1. To continue with this example, a firm that was automatically deemed to participate in Pilot Year 2 and determines in mid-Pilot Year 2 that it does not want to automatically continue into Pilot Year 3 could elect to withdraw from Pilot Year 3 if it provides FINRA an opt-out notice at least five calendar days before the end of Pilot Year 2. However, because Pilot Year 2 is already underway, the firm would be required to complete Pilot Year 2 in accordance with proposed Rule 3110.18.

FINRA believes that this proposed operational aspect of the program would not only establish a cohesive process in which firms and FINRA may manage program participation but also lend some continuity in data and information collection that would support FINRA's assessment and evaluation of the experiences of pilot participants.

5. Definitions (Proposed Rule 3110.18(h))

Proposed Rule 3110.18(h) would set forth the meanings underlying "Pilot Year" to explain the duration of the proposed pilot program. Under proposed Rule 3110.18(h), a "Pilot Year" would mean the following: (1) Pilot Year 1 would be the period beginning on the effective date of the proposed pilot program and ending on December 31 of the same year; (2) Pilot Year 2 would mean the calendar year period following Pilot Year 1, beginning on January 1 and ending on December 31; and (3) Pilot Year 3 would mean the calendar year period following Pilot Year 2, beginning on January 1 and ending on December 31. Finally, if applicable, where Pilot Year 1 covers a period that is less than a full calendar year, then Pilot Year 4 would mean the period following Pilot Year 3, beginning on January 1 and ending on a date that is three years after the effective date.

6. Failure to Satisfy Conditions (Proposed Rule 3110.18(i))

Proposed Rule 3110.18(i) would address a situation in which a firm fails to satisfy terms of the proposed pilot program. The proposed paragraph would provide that a firm that fails to satisfy the conditions of Rule 3110.18, including the requirement to timely collect and submit the data and information to FINRA as set forth in proposed Rule 3110.18(f), would be ineligible to participate in the pilot program and must conduct on-site inspections of each office and location on the required cycle in accordance with Rule 3110(c).

7. Sunset of Rule 3110.17 (Proposed Rule 3110.18(j))

Proposed Rule 3110.18 would expressly account for the possibility that the proposed pilot program becomes effective while Rule 3110.17 is in effect to avoid overlapping provisions. Proposed paragraph (j) would provide that if Rule 3110.17 has not already expired by its own terms, it would automatically sunset on the effective date of proposed Rule 3110.18.

Consistent with the principles set forth in prior guidance, FINRA expects members to establish reasonably designed inspection programs. The proposed pilot program for remote inspections does not alter the core obligation of a member firm to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.⁵² As part of the inspection planning process, FINRA expects members to continue with their ongoing supervision, including risk analysis of the activities and functions occurring at all offices or locations. While the

⁵² See Rule 3110(a).

option to conduct remote inspections provides greater choice in how to effectively supervise some offices or locations, a member must continue to consider the factors described in Rule 3110.12, along with the activities taking place there. This analysis may require the member to conduct a physical, on-site inspection of an office or location. Where there are indications of problems or red flags at any office or location, FINRA expects members to investigate them as they would for any other office or location subject to Rule 3110(c), which may include an unannounced, on-site inspection of the office or location. FINRA is committed to diligently monitoring the impacts of remote inspections on a firms' overall supervisory systems and reviewing the data over the life of the proposed pilot program to assess how firms apply the flexibility provided by the pilot program while maintaining an effective supervisory program.

As noted in Item 2 of this filing, if the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁵³ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The terms of the proposed voluntary, three-year remote inspection pilot program, while based largely on the terms of Rule 3110.17, which has been operational since the

⁵³ 15 U.S.C. 78o-3(b)(6).

latter part of 2020 and is set to automatically sunset on December 31, 2022, would include important safeguards that would require individual risk assessments of each office, supplemental written supervisory procedures related to remote inspections, documentation requirements and obligations to share data with FINRA to allow for assessment of the pilot program. The proposed rule change is intended to provide firms that are transitioning to a hybrid work environment the option to conduct remote inspections of their offices and locations, subject to specified conditions, while maintaining effective supervision. FINRA believes that the proposed pilot program would provide FINRA the appropriate amount of time and population sample to better evaluate the use of remote inspections in the unfolding office work environment. FINRA believes the proposed pilot program, with the proposed safeguards and controls, will provide firms more flexibility to adapt to changing work conditions. The proposed pilot program would aid in FINRA's assessment of the effectiveness of a flexible remote inspection option and its utility in an environment that is increasingly moving to hybrid workplace models, without compromising investor protection.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to

the current baseline, and the alternatives FINRA considered in assessing how best to meet FINRA's regulatory objectives.

A. Regulatory Need

The proposed pilot program would serve two purposes. First, it would mitigate potential disruptions to the hybrid work arrangements that have developed during the pandemic. In particular, for participating members, the proposed pilot program would limit the increase in aggregate inspection costs, and the resulting incentive to reduce the number and type of work locations, that would occur when temporary relief provided during the pandemic expires.⁵⁴ The proposed pilot program would not eliminate the need for such adjustments, but it would allow member firms to focus their on-site inspections on riskier locations.

The proposed pilot program would also allow FINRA to assess the benefits and costs of allowing some element of remote inspection of branch offices and non-branch locations, under specified conditions, in the post-pandemic world. FINRA would obtain information from participating members on certain elements of the risk-based approach that they implement, the type and frequency of inspections, and certain outcomes

⁵⁴ According to the April Survey of Working Arrangements and Attitudes (SWAA), post-COVID, many employers are planning to allow employees to work from home between two and three days per week. See Jose Maria Barrero, Nicholas Bloom & Steven J. Davis, SWAA April 2022 (April 11, 2022), https://wfhresearch.com/wp-content/uploads/2022/04/WFHResearch_updates-April-2022.pdf. The number of expected work-from-home days post-pandemic has been increasing steadily since the January 2021 survey. The SWAA is monthly survey with respondents that are working-age persons in the United States that had earnings of at least \$20,000 in 2019. Further details about this survey can be found in <https://wfhresearch.com>.

conditional on the type and frequency of inspections, as well as the type of office or location inspected.

B. Economic Baseline

The economic baseline for the proposed rule change includes both current and foreseeable workforce arrangements and business practices, including those that were first developed during the pandemic and have been modified since. In particular, the economic baseline includes the innovations, and investments in communication and surveillance technology, that have supported and continue to support supervision in the remote work environment.⁵⁵ These innovations and investments were developed during the temporary relief allowing remote inspections in Rule 3110.17, and the temporary suspension of the requirement to submit branch office applications on Form BR for new office locations provided in Notice 20-08. The baseline includes the scheduled expiration of Rule 3110.17 on the effective date of the proposed Rule 3110.18; and, in order to provide a full accounting of the likely effects of the proposed rule change, the analysis also assumes that, going forward, the temporary suspension of the above requirement is no longer in effect. FINRA expects that numerous additional office locations would then need to be registered, greatly expanding the number of inspections, and all inspections would then need to be conducted on-site.

⁵⁵ The pandemic propelled increased reliance on technology solutions in the remote work environment. A Thompson Reuters survey of compliance and risk practitioners shows a 70% increase in the reliance on technological solutions and 30% of respondents expected increases in the budget for RegTech solutions, specifically. See Thompson Reuters, FinTech, RegTech and the Role of Compliance 2021, <https://legal.thomsonreuters.com/content/dam/ewp-m/documents/legal/en/pdf/reports/fintech-regtech-and-the-role-of-compliance-in-2021.pdf>.

As of April 30, 2022, FINRA's membership included 3,365 firms with 151,463 registered branch offices.⁵⁶ Of these branch offices, 18,290 (12%) are OSJs subject to an annual inspection requirement. The remaining 133,173 branch locations are non-OSJ branch offices subject to an inspection requirement at least annually or every three years. In addition, according to FINRA estimates, there are more than 66,054 non-branch locations, of which 37,290 are private residences.⁵⁷ A non-branch location must be inspected on a periodic schedule, presumed to be at least every three years. These data may be affected by the temporary relief from certain requirements to update Form U4 and to submit Form BR provided in Notice 20-08. FINRA estimates that member firms conduct approximately 84,700 inspections per year.

FINRA adopted temporary Rule 3110.17 in late 2020 and the temporary rule has been extended twice since.⁵⁸ Hence, as of June 2022, member firms have been able to conduct remote inspections for 18 months. FINRA staff considered findings from FINRA's examination of member firms and their branch locations that took place in between 2018 and 2021. This preliminary review found no significant departures relative to pre-pandemic examination results.⁵⁹

⁵⁶ This count excludes firms with membership pending approval, and withdrawn or terminated from membership.

⁵⁷ Non-branch locations do not have to be registered with FINRA. The estimates for non-branch locations, including those that are also private residences, are obtained by reviewing Form U4. There may be some double counting of non-branch locations if members record the address differently on more than one Form U4 (e.g., use "St." on one and "Street" on another).

⁵⁸ See notes 6 and 32, supra.

⁵⁹ FINRA examinations generally review member activities for the year preceding the examination, and the vast majority of examinations takes place during the first

C. Economic Impacts

As discussed above, absent the proposed rule change, FINRA expects that numerous additional office locations will need to be registered, greatly expanding the number of inspections, and all inspections would then need to be conducted on site. The economic impacts of these changes would be mitigated by the proposed rule change for firms that choose to participate in the pilot program.⁶⁰

Participants in the pilot program would be expected to take a risk-based approach to conducting remote inspections. A firm that does not conduct a remote inspection for an office or location must conduct an on-site inspection of that office or location on the

10 months of the calendar year. Examinations check for compliance with federal laws, rules and regulations; the specific areas examined in a firm are based on the risk profile of the firm. FINRA publishes an annual summary of key observations and best practices across all examinations. See the published reports at <https://www.finra.org/rules-guidance/key-topics/finra-examination-risk-monitoring-programs#guidance>. Due to this time lag in FINRA examinations, findings may reflect decisions about remote inspections made by members preceding examinations up to 12 months. Hence, most FINRA examinations in 2020 will reflect member planning undertaken prior to the adoption of Rule 3110.17. Conversely, 66% of FINRA examinations for calendar 2021 have not been finalized. In addition, FINRA examinations of member firms and their activities are risk-based. Given the focus on higher risk firms and some variations in the areas of focus in examinations, year-on-year comparisons should be treated with caution.

⁶⁰ Separately, FINRA has filed a proposed rule change to establish a Residential Supervisory Location (“RSL”), a new non-branch location, that would, relative to the baseline, reduce the number of inspections that members with RSLs would need to conduct in a year. See Securities Exchange Act Release No. 95379 (July 27, 2022) (Notice of Filing of File No. SR-FINRA-2022-019). For member firms with locations that would meet the proposed definition of an RSL, the aggregate cost savings from choosing to participate in the proposed pilot program would be lower if the RSL proposal were in place because the cost savings from remote inspections would accrue over fewer inspections. The qualitative impacts of the proposed pilot program, however, are similar whether the proposed definition of an RSL is adopted or not.

required cycle and remains subject to the other requirements of Rule 3110(c). A firm that chooses to participate in the pilot program (assuming that it is not otherwise ineligible from participating) would also be required to provide FINRA with certain data and other information about the risk-based approach that they implement, the type and frequency of inspections, and certain outcomes conditional on the type and frequency of inspections.

Anticipated Benefits

The benefit to firms of choosing to participate in the pilot program, in an improved health environment, would result from limiting the increase in travel costs and lost productivity due to time spent during travel and in the on-site inspection. On-site visits have material costs from travel expenses and additional staff time. A system of risk-based on-site and remote inspections will allow firms to more efficiently deploy compliance resources and to use an on-site component only when appropriate.

Firms as well as investors may benefit if remote inspections provide new flexibility in the design of inspection teams. For example, remote inspections may facilitate the development of specialized inspection staff that are deployed over more inspections, for shorter periods of time, in a targeted way. This option may especially benefit diversified member firms with a variety of product offerings. Remote inspections can also facilitate the use of inspections that target a particular area of focus in a member firm's business across all branches of the member firm.

The proposed rule change may also support the competitiveness of the broker-dealer industry for individuals who seek professional positions in compliance.⁶¹ The

⁶¹ See note 55, *supra*. See also Jose Maria Barrero, Nicholas Bloom & Steven J. Davis, *Why Working from Home Will Stick* (NBER Working Paper 28731, April 2021), <https://wfhrsearch.com/wp-content/uploads/2021/04/w28731-3-May->

expectation of workplace flexibility and remote work by such individuals may lead them away from the broker-dealer industry if other segments of financial services or professional occupations offer more flexible workforce arrangements, with regulatory frameworks that offer more discretion in how the supervision is conducted.⁶² Even prior to the pandemic, the scope of on-site inspections had been much reduced due to technological surveillance solutions and centralization of books and records. The proposed pilot would support continued adoption and innovation in technological solutions and reductions in the cost of these solutions.

Participants in the proposed pilot program would provide FINRA with periodic (not to exceed quarterly) data on the frequency and type of inspections (on-site or remote), counts of findings from inspections subdivided by category of office or location, qualitative information about these findings, and certain information about the written supervisory procedures for remote inspections they are required to have.⁶³ Depending on the number and types of firms that participate in the proposed pilot program, this data may allow FINRA to identify differences in risks between remote versus on-site

2021.pdf, who point to a lasting effect of the pandemic on work arrangements, in particular for those with higher education and earnings; and Alexander Bick, Adam Blandin & Karel Mertens, Work from Home Before and After the COVID-19 Outbreak, (Working Paper, February 2022), https://karelmertenscom.files.wordpress.com/2022/02/wfh_feb17_2022_paper.pdf, who find consistent results, with a higher adoption rate of work from home jobs in Finance and Insurance, relative to other industries, reflected in Figure 10.

⁶² For example, Advisers Act Rule 206(4)-7 does not require Registered Investment Advisers to conduct in-person inspections or reviews of its offices or personnel.

⁶³ In addition, if the effective date of the rule is such that the first year of the pilot program covers a period less than a full calendar year, participating firms would be required to provide, the data and information specified in proposed Rule 3110.18(f)(2).

inspection, both conditional on the observable characteristics and policies of firms and overall, the extent of variation in these risks across firms and firm characteristics, and factors associated with very high or low risks. The proposed pilot program has the potential to yield a more thorough collection of sensitive information in a structured manner than voluntary submissions or a survey of FINRA members could provide. This data will be useful both for monitoring for risks as the pilot proceeds and, with sufficient participation, for developing a balanced assessment of the potential impact of permitting further remote inspection.

Anticipated Costs

Participation in the proposed pilot program is voluntary, and the proposed rule change provides firms with an additional method for complying with certain supervisory requirements without removing other methods of compliance. Eligible pilot participants will therefore participate in the pilot program only if doing so is beneficial to their operations relative to complying with current Rule 3110. The cost of complying with the requirements of the proposed pilot program is a factor in this decision. These costs include conducting risk-based analyses for inspections and providing aggregated data on findings to FINRA. The data request in particular may require more standardization and aggregation of inspection findings than some member firms typically conduct. The data request may also not use the same terms or formats used by compliance officers for reporting and tracking inspection findings. Firms may need to develop new written supervisory procedures and new trainings for compliance staff to ensure that all required data is accurate and compiled and submitted to FINRA in a timely manner. Firms will incur new ongoing costs both for compliance and monitoring for compliance.

Supervision and inspections are intended to identify not only the activities that violate member procedures or FINRA rules but also poor practices that might ultimately allow for such violations. FINRA recognizes that remote inspections may be less likely to identify such practices or activities as on-site inspections. FINRA believes that risks to member firms and investors from remote inspections are mitigated by the proposed requirements to have written supervisory procedures for remote inspections, the proposed requirement to conduct and document risk assessments, the proposed limitations on the firms and locations that would be eligible to participate in the proposed pilot program, and the technology already employed for day-to-day supervision. In addition, FINRA will continue to closely monitor the outcomes of examinations during the pilot program period.

D. Alternatives Considered

The proposed pilot program would continue for three years. FINRA staff considered alternative durations for the program. FINRA members firms vary by business model and organizational structure, so a shorter program is less likely to yield enough data on inspection findings to allow for meaningful comparisons between on-site and remote inspection regimes across members. In addition, inspections are typically planned by members well ahead of time, so some members may not implement the requirements of the program until well into the duration of the pilot program. It may also help firms and the policy development process if FINRA had enough data to meaningfully evaluate well ahead of the expiration of the pilot program.

FINRA staff also considered a proposed pilot program that would not exclude certain firms, like restricted firms, from participating in the program. These additional

restrictions will limit the availability of the pilot program as well as the potential learnings from the program. As a result, the same restrictions may ultimately need to be carried over into any ongoing program of risk-based examinations. The exclusion of such firms, however, should reduce any risk of customer harm from not having on-site inspections.⁶⁴

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.⁶⁵

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

⁶⁴ See Zachary T. Kowaleski, Andrew G. Sutherland & Felix W. Vetter, Supervisor Influence on Employee Financial Misconduct (Working Paper, July 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3646617. This paper presents evidence that could be interpreted as supportive of the exclusions based on misconduct and lack of experience.

⁶⁵ 15 U.S.C 78s(b)(2).

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2022-021)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA Rule 3110 (Supervision) to adopt a voluntary, three-year remote inspection 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 branch offices and locations remotely without an on-site visit to such office or location, subject to specified terms.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

The text of the proposed rule change is available on FINRA's website at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Beginning many years ago, SEC staff and FINRA have interpreted FINRA rules to require member firms to conduct on-site inspections of branch offices and unregistered offices (*i.e.*, non-branch locations) in accordance with the periodic schedule described under Rule 3110(c)(1).³ Over the years, widespread advancements in technology and

³ See SEC National Examination Risk Alert, Volume I, Issue 2 (November 30, 2011), <https://www.sec.gov/about/offices/ocie/riskalert-bdbranchinspections.pdf> and Regulatory Notice 11-54 (November 2011) ("Notice 11-54") (joint SEC and FINRA guidance stating, a "broker-dealer must conduct on-site inspections of each of its office locations; [Office of Supervisory Jurisdiction ("OSJs")] and non-OSJ branches that supervise non-branch locations at least annually, all non-supervising branch offices at least every three years; and non-branch offices periodically."). See also SEC Division of Market Regulation, Staff Legal Bulletin No. 17: Remote Office Supervision (March 19, 2004) ("SLB 17") (stating, in part, that broker-dealers that conduct business through geographically dispersed offices have not adequately discharged their supervisory obligations where there are no on-site routine or "for cause" inspections of those offices), <https://www.sec.gov/interp/legalslrb17.htm>.

communications in the financial industry have significantly changed the way in which members and their associated persons conduct their business and communicate, including the practices that formed the original bases for an on-site inspection requirement. For example, making and preserving records electronically have increasingly become the norm and the preferred recordkeeping medium rather than paper (e.g., cloud based storage); communications between and among members, their associated persons and customers commonly take place through email, video or some other electronic means (e.g., WebEx, Zoom) that can be monitored electronically by firms; processes for opening customer accounts and placing trades are moving to online platforms; and customer funds and securities are frequently and increasingly transmitted electronically rather than in physical form (e.g., Venmo, Zelle). Relatedly, the challenges in supervising associated persons who work in outlying offices or locations have been mitigated over the years with the prevalent and effective use of technology. For example, supervisory reviews for outside business activities of associated persons are often conducted through general internet searches, including social media and online public records, and by reviewing electronic communications and customer fund transfers. Similarly, reviews of correspondence, customer funds and securities, and order flows are accomplished primarily through the use of electronic tracking programs or applications.

FINRA notes that firms are turning to new and innovative regulatory tools such as artificial intelligence, natural language processing, and robotics process automation, among others, to strengthen their compliance programs.⁴ More recently, firms have

⁴ See generally FINRA White Paper, Technology Based Innovations for Regulatory Compliance (“RegTech”) on the Securities Industry (September 2018), https://www.finra.org/sites/default/files/2018_RegTech_Report.pdf.

questioned the benefits of the on-site inspection requirement for all offices, particularly in light of these significant technological advances that have enhanced the effectiveness of a firm's overall and ongoing supervision and monitoring of the activities occurring at their offices (registered and unregistered).⁵

The COVID-19 pandemic has accelerated the use of a wide variety of compliance and workplace technology as many government and private employers, including member firms, were driven to adopt a broad remote work environment by quickly moving their employees out of their usual office setting to an alternative worksite such as a private residence. Insights obtained from member firms and other industry representatives through various pandemic-related initiatives and other industry outreach have led FINRA to carefully consider whether some processes and rules, including the manner in which a firm may satisfy its Rule 3110(c) obligations, should be modernized.⁶

⁵ Some firms have indicated, for example, that technology has enhanced real time monitoring of their associated persons by providing the ability for firm compliance personnel to join, on an ad hoc basis, digital or virtual meetings occurring between the firm's associated persons and customers. Firms have also indicated that technology has allowed them to impose various restrictions or limitations on associated persons, such as the ability to print firm records from remote locations using a firm-issued laptop, and only accepting electronic payments from customers.

⁶ See generally FINRA's Key Topic: COVID-19/Coronavirus (referencing, among other things, Frequency Asked Questions, temporary amendments to FINRA rules, and Regulatory Notices such as Regulatory Notices 20-08 (March 2020) ("Notice 20-08"), regarding pandemic-related business continuity planning, guidance and regulatory relief to member firms from some requirements, including the temporary suspension of the requirement to maintain updated information on Form U4 (Uniform Application for Securities Industry Registration or Transfer) and submit Form BR (Uniform Branch Office Registration Form) for temporary locations; 20-16 (May 2020) ("Notice 20-16"), describing practices implemented by firms to transition to, and supervise in, remote work environment during the COVID-19 pandemic; 20-42 (December 2020) ("Notice 20-42"), seeking comment on lessons from the pandemic; and 21-44 (December 2021) ("Notice 21-44"), regarding business continuity planning

Technological improvements and developments in regulatory compliance have provided more tools than before to create more effective and efficient compliance programs. To that end, FINRA believes that regulatory models should evolve to benefit from the availability and use of effective technology tools. With the confluence of advances in compliance technology and the permanent shift to a remote or hybrid work environment, made more pronounced by the pandemic, FINRA believes that the optimal use of on-site inspections deserves further consideration.

To address the operational challenges in conducting on-site inspections during the pandemic, FINRA adopted temporary Rule 3110.17, effective since November 2020, to provide member firms the option to conduct inspections of their branch offices and non-branch locations remotely, subject to specified terms therein.⁷ Although uncertainty about the pandemic remains, firms are beginning to look ahead at the post-pandemic changes to their workplaces, including more flexible work hours and hybrid work models—working sometimes on-site in a conventional office setting and other times remotely in a private residence or other alternative worksite. As such, FINRA believes now is the time to assess possible longer-term rule changes and is, therefore, proposing a voluntary, three-year remote inspections pilot program. This program would provide

and lessons from the pandemic, <https://www.finra.org/rules-guidance/key-topics/covid-19>. See also SEC Press Release 2022-112 (June 22, 2022) for the Spring 2022 Regulatory Agenda (quoting SEC Chair Gary Gensler: “When I think about the SEC’s agenda, I’m driven by two public policy goals: continuing to drive efficiency in our capital markets and modernizing our rules for today’s economy and technologies.”), https://www.sec.gov/news/press-release/2022-112?utm_medium=email&utm_source=govdelivery.

⁷ See Securities Exchange Act Release No. 90454 (November 18, 2020), 85 FR 75097 (November 24, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-040).

FINRA with specific, structured data from member firm pilot participants to evaluate their experiences—positive and negative—and inspection findings. This data would enable FINRA to systematically assess the overall impact on firms’ supervisory systems, which has not been feasible with information drawn from the pandemic-related office shutdowns. Moreover, the proposed pilot program would maintain effective supervision by firms through firms’ ongoing supervisory obligations under Rule 3110, and the proposed limitations on the firms and locations that would be eligible to participate in the proposed pilot program.

The Inspection Requirement Under Rule 3110

The responsibility of firms to supervise their associated persons is a critical component of broker-dealer regulation.⁸ Member firms must supervise all of their associated persons, regardless of their location, compensation or employment arrangement, or registration status.⁹ Rule 3110 requires a member, regardless of size or

⁸ See SLB 17, *supra* note 3; see also Notice 11-54 and Notice to Members 98-38 (May 1998) (“Notice 98-38”).

⁹ This obligation is derived from Sections 15(b)(4)(E) and 15(b)(6)(A) of the Exchange Act. Section 15(b)(4)(E) provides that the “Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer if it finds . . . that such broker or dealer . . . or any person associated with such broker or dealer . . . has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any person of any provision of the Securities Act of 1933, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, [the Securities Exchange Act of 1934], the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, or has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision.” 15 U.S.C. 78o(b)(4)(E). Section 15(b)(6)(A)(i) parallels Section 15(b)(4)(E) and provides for the imposition of sanctions against persons associated with a broker or dealer that violates those statutes, rules and

type, to have a supervisory system for the activities of its associated persons that is reasonably designed to achieve compliance with the applicable securities laws and regulations and FINRA rules, and sets forth the minimum requirements for such supervisory system.¹⁰

As part of that supervisory system, Rule 3110(c) requires a member to review, at least annually, the businesses in which it engages for purposes of detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations. The review must include periodic inspections of each office and examination of customer accounts to detect and prevent irregularities and abuses. The inspection requirement is a longstanding supervisory obligation that in its early form had addressed the inspection requirement for an OSJ only.¹¹ FINRA expanded the inspection requirement to cover branch offices out of concern for the potential regulatory problems that could emerge when a registered person, situated in an office other than an OSJ, was engaging in securities-related activities without the direct oversight of qualified supervisory personnel and without an annual inspection.¹²

regulations enumerated in Section 15(b)(4)(E) and other specified subparagraphs under Section 15(b)(4). 15 U.S.C. 78o(b)(6)(A).

¹⁰ See Rule 3110(a).

¹¹ Article III, Section 27(d) of the NASD Rules of Fair Practice had provided: “Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses and at least an annual inspection of each office of supervisory jurisdiction.” See Notice to Members 87-41 (June 1987) (setting forth the then existing rule text for specified parts of Article III, Section 27 (Supervision) of the NASD Rules of Fair Practice as part of a proposal to amend the OSJ and branch office definitions).

¹² See Securities Exchange Act Release No. 26177 (October 13, 1988), 53 FR 41008 (October 19, 1988) (Order Approving File No. SR-NASD-88-31). See also

Currently, Rule 3110(c) sets forth three main requirements for conducting internal inspections. First, an inspection of an office or location must occur on a designated frequency. The periodicity of the required inspection varies depending on the classification of the location or the nature of the activities that take place: OSJs and supervisory branch offices must be inspected at least annually;¹³ non-supervisory branch offices, at least every three years;¹⁴ and non-branch locations, on a periodic schedule, presumed to be at least every three years.¹⁵ Second, a member must retain a written record of the date upon which each review and inspection occurred, reduce a location's inspection to a written report and keep each inspection report on file either for a minimum of three years or, if the location's inspection schedule is longer than three years, until the next inspection report has been written.¹⁶ If applicable to the location being inspected, the inspection report must include the testing and verification of the member's policies and procedures, including supervisory policies and procedures, in specified areas.¹⁷ Third, to prevent compromising the effectiveness of inspections due to

Notice to Members 88-84 (November 1988) and Notice to Members 89-34 (April 1989).

¹³ See Rule 3110(c)(1)(A).

¹⁴ See Rule 3110(c)(1)(B).

¹⁵ See Rules 3110(c)(1)(C) and 3110.13 (General Presumption of Three-Year Limit for Periodic Inspection Schedules).

¹⁶ See Rule 3110(c)(2).

¹⁷ See Rule 3110(c)(2)(A) (providing that the inspection report must include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures for: (1) safeguarding of customer funds and securities; (2) maintaining books and records; (3) supervision of supervisory personnel; (4) transmittals of funds from customers to third party accounts, from customer accounts to outside entities, from customer accounts to

conflicts of interest, the rule requires a member to ensure that the person conducting the inspection is not an associated person assigned to the location or is not directly or indirectly supervised by, or otherwise reporting to, an associated person assigned to that location.¹⁸ All branch offices and non-branch location are subject to Rule 3110(c).

Further, Rule 3110.12 (Standards for Reasonable Review) sets out factors that constitute a reasonable review. This provision emphasizes establishing reasonable supervisory procedures and conducting reviews of locations, taking into consideration, among other things, the member's size, organizational structure, scope of business activities, number and location of the member's offices, the nature and complexity of the products and services offered by the member, the volume of business done, the number of associated persons assigned to a location, the disciplinary history of registered representatives or associated persons, and any indicators of irregularities or misconduct (i.e., "red flags").¹⁹ The provision further states that the procedures established and

locations other than a customer's primary residence, and between customers and registered representatives, including the hand delivery of checks; and (5) changes of customer account information, including address and investment objectives changes, and validation of such changes).

¹⁸ Rule 3110(c)(3) provides a limited exception from this requirement if a firm determines compliance is not possible either because of the firm's size or its business model. Rule 3110.14 (Exception to Persons Prohibited from Conducting Inspections) reflects FINRA's expectation that a firm generally will rely on the exception in instances where the firm has only one office or has a business model where small or single-person offices report directly to an OSJ manager who is also considered the offices' branch office manager. However, these situations are non-exclusive, and a firm may still rely on the exception in other instances where it cannot comply because of its size or business model, provided the firm complies with the documentation requirements under the rule.

¹⁹ Red flags that suggest the existence or occurrence of violations, prompting an unannounced visit, may include: customer complaints; a large number of elderly customers; a concentration in highly illiquid or risky investments; an unexplained increase or change in the types of investments or trading concentration that a

reviews conducted must provide that the quality of supervision at remote (i.e., geographically dispersed) locations is sufficient to ensure compliance with applicable securities laws and regulations and with FINRA rules, and that members must be especially diligent with respect to a non-branch location where a registered representative engages in securities activities. This provision incorporates guidance FINRA has previously issued about supervising associated persons working in geographically dispersed offices.²⁰

In 2004, the SEC staff similarly provided guidance on supervision principles.²¹ At that time, the SEC staff noted that small, geographically scattered offices presented supervisory challenges when they were not subject to on-site supervision. The SEC staff observed that an office's geographic distance from supervisory personnel could make it easier for registered persons and other employees to carry out and conceal violative conduct. This general observation was derived from SEC enforcement cases finding that firms had inadequately supervised their associated persons working in small,

representative is recommending or trading; an unexpected improvement in a representative's production, lifestyle, or wealth; questionable or frequent transfers of cash or securities between customer or third party accounts, or to or from the representative; a representative that serves as a power of attorney, trustee or in a similar capacity for a customer or has discretionary control over a customer's account(s); representative with disciplinary records; customer investments in one or a few securities or class of securities that is inconsistent with firm policies related to such investments; churning; trading that is inconsistent with customer objectives; numerous trade corrections, extensions, liquidations; or significant switching activity of mutual funds or variable products held for short time periods. See SLB 17, supra note 3; see also Notice 98-38 and Notice to Members 99-45 (June 1999) ("Notice 99-45").

²⁰ See, e.g., Notices 98-38 and 99-45.

²¹ See SLB 17, supra note 3.

geographically distant offices due to the failure of their supervisory mechanisms to detect and prevent misconduct. Citing technology available at the time, the guidance emphasized that an effective supervisory system for geographically dispersed offices uses a combination of on-site and off-site monitoring; it specifically said that “[c]entralized technology to monitor the trading and handling of funds in remote office accounts, as well as the use of personal computers, helps detect misappropriation of customer funds, selling away, and unauthorized trading, among other things[.]”²² The guidance supported both routine or “for cause” on-site inspections, and encouraged unannounced inspections either on a random basis or where there are red flags about unusual activity at those offices. Further, as noted above, in the past both the SEC staff and FINRA have expressed the view that inspections must have an on-site component, reflecting how office inspections have been historically conducted.²³

Since the time these in-person guidelines were expressed, developments in technology have enhanced firms’ overall and ongoing supervision and monitoring of the activities occurring at branch offices and non-branch locations. In response to these developments, member firms have questioned the historical expectation that firms satisfy the inspection component of Rule 3110(c) solely in a physical, on-site manner.

The 2017 Proposal to Allow Remote Inspections and the Impact from the Pandemic

Even prior to the pandemic, in 2017, FINRA considered a proposal to give firms the option of satisfying the inspection requirement remotely for “qualifying offices” that

²² See SLB 17, supra note 3.

²³ See note 3, supra.

met specified criteria.²⁴ However, the COVID-19 pandemic, declared in early 2020,²⁵ significantly changed the industry's standard business operations, forcing member firms to adapt to a full remote work environment and implement remote supervisory practices.²⁶ FINRA deferred the 2017 Proposal in light of the pressing need to address significant operational disruptions to the securities industry, regulators, impacted member firms, investors and other stakeholders. During this exigent period, FINRA responded to numerous issues and questions that urgently arose.²⁷ Following up on these actions, FINRA published Notice 20-42 to gain a broader understanding of member firm experiences during the pandemic. This notice sought feedback from firms about their experiences in a range of areas, including how member firms' operations and business models changed during the public health crisis and how they might further evolve as the pandemic persisted. Other initiatives included sharing general practices of firms in transitioning and supervising in the remote work environment, and providing temporary

²⁴ See Regulatory Notice 17-38 (November 2017) ("2017 Proposal"). FINRA had requested comment on a proposed amendment to Rule 3110 to allow remote inspections of "qualifying offices" that met specified criteria, in lieu of on-site inspections of such offices and locations. In general, many of the comment letters FINRA had received expressed support for the underlying concept of remote inspections and offered recommendations on specific criteria to broaden the potential population of qualifying offices.

²⁵ See Centers for Disease Control and Prevention ("CDC"), International Classification of Diseases, Tenth Revision, Clinical Modification (ICD-10-CM) (Effective March 18, 2020), <https://www.cdc.gov/nchs/data/icd/Announcement-New-ICD-code-for-coronavirus-3-18-2020.pdf>. See also WHO Director-General, Opening Remarks at the Media Briefing on COVID-19 (March 11, 2020), <https://www.who.int/director-general/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020>.

²⁶ See generally Regulatory Notice 20-16 (May 2020).

²⁷ See note 6, supra.

relief to member firms from specified FINRA rules and requirements.²⁸ In particular, to give firms an opportunity to better manage their operational challenges and redirect resources attendant to fulfilling their inspection obligations, FINRA provided temporary relief to member firms pertaining to the in-person inspection aspect of Rule 3110(c).²⁹

Temporary Amendments to the Inspection Requirement Under Rule 3110(c)

At the outset of the pandemic in the United States, many states issued stay-at-home orders and imposed restrictions on businesses, social activities, and travel in hopes of slowing the spread of COVID-19.³⁰ In response, many government and private employers, including member firms, closed their offices and moved their employees to alternative worksites (e.g., an employee's residence). These operational changes made it impracticable for member firms to conduct the on-site inspection component of Rule 3110(c) at most locations for that year because of limitations on travel to geographically dispersed OSJs, branch offices, and non-branch locations. In response to the logistical challenges, FINRA extended the time by which member firms were required to complete their calendar year 2020 inspection obligations under Rule 3110(c) to March 31, 2021 with the expectation that the extension did not relieve firms from the on-site portion of

²⁸ Some temporary amendments to other FINRA rules still remain in effect. See Securities Exchange Act Release No. 95281 (July 14, 2022), 87 FR 43335 (July 20, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-018) (extending the expiration date of temporary amendments set forth in SR-FINRA-2020-015 and SR-FINRA-2020-027).

²⁹ See Rules 3110.16 and 3110.17.

³⁰ See note 7, supra, 85 FR 75097, 75098 n.10.

the inspections of their offices and locations.³¹ However, health and safety concerns remained unabated and with many restrictive measures still in place as calendar year 2020 was ending, FINRA adopted Rule 3110.17 to provide member firms the option, subject to specified requirements under the supplementary material, to complete remotely their calendar year inspection obligations without an on-site visit to the office or location.³² This relief was repeatedly extended until the end of 2022.³³ Rule 3110.17 will automatically sunset on December 31, 2022.³⁴

Through comments to the 2017 Proposal, Notice 20-42, the various temporary amendments to Rule 3110, and other engagement with industry representatives, firms have highlighted that Rule 3110(c) was adopted well before the prevalence of modern technology, including laptops, mobile devices, video conferencing capabilities, electronic storage and electronic surveillance, at a time when on-site inspections were the only conceivable way firms could inspect and review activities occurring in outlying offices and locations. The advent of new and developing technologies has enhanced the effectiveness of a firm's ongoing supervision and monitoring of associated persons working from dispersed branch offices and non-branch locations. In addition, firms have

³¹ See Securities Exchange Act Release No. 89188 (June 30, 2020), 85 FR 40713 (July 7, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-019).

³² See note 7, supra.

³³ See Securities Exchange Act Release No. 93002 (September 15, 2021), 86 FR 52508 (September 21, 2021) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2021-023); and Securities Exchange Act Release No. 94018 (January 20, 2022), 87 FR 4072 (January 26, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-001).

³⁴ See note 33, supra.

noted that in practice, those technological advances allow a large portion of inspection work to be conducted electronically, prior to any on-site visit to the office and location, and that in general, on-site inspections of many offices and locations are one component of a firm's overall supervisory system of associated persons and offices, and as such are no longer an efficient and effective use of limited firm resources.³⁵

However, Rule 3110.17 was adopted in the midst of the pandemic, when many offices and locations were closed, and employees carried out their responsibilities from alternative worksites. FINRA recognizes that the pandemic has changed the conventional thinking on where work is conducted and this shift in the workforce landscape will unlikely revert to the model that existed pre-pandemic. As noted above, FINRA believes that adopting a voluntary, three-year remote inspection pilot program, under terms based largely on Rule 3110.17, but with significant safeguards, would allow FINRA the time to collect specified data from member firm pilot participants to evaluate their experiences

³⁵ In response to FINRA's proposed rule changes associated with Rule 3110.17, one commenter made similar points about the physical, on-site piece of the inspection process. This commenter stated that pre-pandemic, an on-site inspection of a branch office typically consisted of reviewing the lobby area of the office, the back office (to review safe contents, sales literature, daily operations logs containing account applications), signage, and the physical security of the office. See Letter from Carrie L. Chelko, Chief Compliance Officer, Fidelity Brokerage Services LLC ("Fidelity Brokerage") & Norman L. Ashkenas, Chief Compliance Officer, National Financial Services LLC ("NFS") and Fidelity Distributors Company LLC ("Fidelity Distributors"), to Vanessa Countryman, Secretary, SEC, dated July 28, 2020, in response to Securities Exchange Act Release No. 89188 (June 30, 2020), 86 FR 40713 (July 7, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-019) and Letter from Gail Merken, Chief Compliance Officer, Fidelity Brokerage, Janet Dyer, Chief Compliance Officer, NFS & John McGinty, Chief Compliance Officer, Fidelity Distributors, to Vanessa Countryman, Secretary, SEC, dated February 16, 2022, in response to Securities Exchange Act Release No. 94018 (January 20, 2022), 87 FR 4072 (January 26, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-001).

and inspection findings in a uniform, comparable manner in the context of the emerging hybrid work model. FINRA anticipates that the proposed pilot program will provide broader systemized information to supplement the information obtained through the FINRA examination process in an environment where offices and locations were closed. The information firms will be required to produce as a pilot program participant will help FINRA more accurately assess the overall impacts on firms' supervisory systems to inform FINRA's application of supervisory requirements to the new work environment, including potentially broader reliance on remote inspections.

Proposed Voluntary, Three-Year Pilot Program for Remote Inspections

With Rule 3110.17 operational since November 2020, and the widespread availability and use of technology described above, regulators are being challenged to consider whether on-site inspections by firms should be a necessity and if they continue to be an efficient and effective method for supervising and monitoring associated persons and offices as part of a firm's overall supervisory system.

As FINRA emphasized in the proposed rule change to adopt Rule 3110.17, the responsibility of firms to supervise their associated persons on a day-to-day basis is a critical component of broker-dealer regulation.³⁶ The inspection requirement in Rule 3110(c) is just one element of a reasonably designed supervisory system. FINRA believes that a pilot period of risk-based on-site supervision is consistent with firms' core responsibility, as set forth in Rule 3110, to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance

³⁶ See note 7, supra.

with applicable securities laws and regulations, and with applicable FINRA rules. The proposed pilot program would build largely on the terms of Rule 3110.17, but would be enhanced in several ways, including notably targeted exclusions from participation in the program for higher risk member firms, and offices or locations. In addition, the proposed pilot program would require a firm conduct a risk assessment for each office or location that is selected to be inspected remotely, documented with the factors considered. Finally, the proposed pilot program would require a firm to establish and maintain written supervisory procedures to account for the risk assessment and sets forth the scope of the program.

A. Scope of Pilot (Proposed Rule 3110.18(a))

Under proposed Rule 3110.18(a), the proposed pilot program would apply to the required inspections of OSJs, branch offices, and non-branch locations under the applicable provisions under Rule 3110(c)(1) for a pilot period of three years starting on the effective date, and expiring on a date that is three years after the effective date. If the proposed pilot program is not extended or Rule 3110.18, as may be amended, is not approved as permanent by the SEC, the proposed supplementary material will automatically sunset on a date that is three years after the effective date. In addition, proposed Rule 3110.18(a) would expressly state that members would not be able to avail themselves of the proposed pilot program after it expires.

B. Use of Remote Inspections (Proposed Rule 3110.18(b))

1. Risk-Based Approach; Risk Assessment (Proposed Rule 3110.18(b)(1))

As described above, Rule 3110(c)(1) provides that an inspection of an office or location must occur on a designated frequency, and the periodicity of the required

inspection varies depending on the classification of the location as an OSJ, branch office or non-branch location. Subject to proposed Rule 3110.18(b)(2) as described below, proposed Rule 3110.18(b)(1) would provide that a member firm may elect to conduct the applicable inspection of an office or location during the pilot period remotely, without necessarily an on-site visit for the office or location, when the member reasonably determines that the purposes of the rule can be accomplished by conducting such required inspection remotely.³⁷ Proposed Rule 3110.18(b)(1) would also provide that prior to electing a remote inspection for an office or location, rather than an on-site inspection, the firm must develop a reasonable risk-based approach to using remote inspections and conduct and document a risk assessment for that office or location. The assessment must document the factors considered, including the factors set forth in Rule 3110.12, and must take into account any higher risk activities that take place or higher risk associated persons that are assigned to that location. FINRA expects that higher risk factors at a particular location would cause a firm to conduct on-site inspections of such location. Further, under the proposed supplementary material, a member that is not eligible to conduct remote inspections under proposed Rule 3110.18(b)(2) must conduct an on-site inspection of that office or location on the required cycle. Finally, notwithstanding the pilot program, a member would remain subject to the other requirements and limitations of Rule 3110(c).³⁸

³⁷ As described further below, a member firm that elects to participate in the proposed pilot program would be subject to the requirements of proposed Rule 3110.18 for a Pilot Year. See proposed Rule 3110.18(g).

³⁸ For example, as currently required with any physical, on-site inspection, a member would be required to reduce the remote inspection to a written report and satisfy the content and record retention requirements of such report as described

2. Ineligible Member Firms, and Offices or Locations (Proposed Rule 3110.18(b)(2))

FINRA is proposing to exclude some member firms or their offices or locations from participating in the proposed pilot program. The proposed categories of ineligibility are events or activities of a member firm or its associated persons that FINRA believes are more likely to raise investor protection concerns based on the firm's or an associated person's record of specified regulatory or disciplinary events.

Under proposed Rule 3110.18(b)(2)(A), a member firm would be ineligible to conduct remote inspections of any of its offices if any time during the period of the proposed pilot program, the member is or becomes: (1) designated as a Restricted Firm under Rule 4111³⁹ (proposed Rule 3110.18(b)(2)(A)(i)); or (2) designated as a Taping Firm under Rule 3170⁴⁰ (proposed Rule 3110.18(b)(2)(A)(ii)). These rules expressly

in Rule 3110(c)(2). Similarly, a member would remain subject to Rule 3110(c)(3)'s general prohibition against an associated person from conducting a location's inspection if the person either is assigned to that location or is directly or indirectly supervised by, or otherwise reports to, someone assigned to that location. Rule 3110(c)(3) provides a limited exception from this general prohibition for specified circumstances (e.g., the member has a business model where a small or single-person offices report directly to an OSJ manager who is also considered the offices' branch office manager) by requiring a member to document in the inspection report both the factors the member used to make the determination that it could not comply with the general prohibition and how the inspection otherwise complies with Rule 3110(c)(1).

³⁹ In general, Rule 4111 (Restricted Firm Obligations) requires member firms that are identified as "Restricted Firms" to deposit cash or qualified securities in a segregated, restricted account; adhere to specified conditions or restrictions; or comply with a combination of such obligations. See generally Regulatory Notice 21-34 (September 2021) (announcing FINRA's adoption of rules to address firms with a significant history of misconduct).

⁴⁰ In general, Rule 3170 (Tape Recording of Registered Persons by Certain Firms) requires a member firm to establish, enforce and maintain special written procedures supervising the telemarketing activities of all of its registered persons, including the tape recording of conversations, if the firm has hired more than a

address firms that pose higher risks, and for that reason, would be ineligible to participate in the proposed pilot program.

In addition, under proposed Rule 3110.18(b)(2)(B), a member firm's office or location would be ineligible for a remote inspection if at any time during the period of the proposed pilot program, an associated person at such office or location is or becomes: (1) subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or state regulatory agency (proposed Rule 3110.18(b)(2)(B)(i)); (2) statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a mandatory heightened supervisory plan under proposed Rule 3110.18(b)(2)(B)(i) or otherwise as a condition to approval or permission for such association (proposed Rule 3110.18(b)(2)(B)(ii)); (3) subject to Rule 1017(a)(7)⁴¹ as a result of one or more associated persons at such location (proposed Rule 3110.18(b)(2)(B)(iii)); or (4) one or more associated persons at such location has an event in the prior three years that required a "yes" response to any item in Questions 14A(1)(a)

specified percentage of registered persons from firms that meet FINRA Rule 3170's definition of "disciplined firm." See generally Regulatory Notice 14-10 (March 2014) (announcing FINRA's adoption of consolidated rules governing supervision).

⁴¹ In general, Rule 1017(a)(7) require a member firm to file a CMA when a natural person seeking to become an owner, control person, principal or registered person of the member firm has, in the prior five years, one or more defined "final criminal matters" or two or more "specified risk events" unless the member firm has submitted a written request to FINRA seeking a materiality consultation for the contemplated activity. Rule 1017(a)(7) applies whether the person is seeking to become an owner, control person, principal or registered person at the person's current member firm or at a new member firm. See generally Regulatory Notice 21-09 (March 2021) (announcing FINRA's adoption of rules to address brokers with a significant history of misconduct).

and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4⁴² (proposed Rule 3110.18(b)(2)(B)(iv)). FINRA believes that the imposition of a mandatory heightened supervisory plan, a statutorily disqualification, a Rule 1017(a)(7) review due to significant misconduct, or the existence of specified disclosures on Form U4 pertaining to criminal convictions and final regulatory action are indicia of increased risk to investors at some office or locations, such that they should not be eligible for remote inspections in accordance with the proposed pilot program.

A member firm or an office or location subject to one of the categorical restrictions would not be eligible for remote inspections, even if the firm's risk assessment concludes that a remote inspection would be appropriate. A member firm would be required to conduct an on-site inspection of that office or location on the required cycle. FINRA believes the proposed list of ineligibility categories is appropriately derived from existing rule-based criteria that are part of processes to identify firms that may pose greater concern (e.g., Rules 4111 and 3170) or associated persons that may pose greater concerns due to the nature of disclosures of regulatory or disciplinary events on the uniform registration forms. FINRA believes that these objective categorical restrictions will provide safeguards that will help ensure that firms maintain effective supervisory procedures during the pilot period.

⁴² Form U4's Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a) elicit reporting of criminal convictions, and Questions 14C, 14D, and 14E pertain to regulatory action disclosures.

C. Written Supervisory Procedures for Remote Inspections (Proposed Rule 3110.18(c))

As part of an effective supervisory system tailored specifically to the member firm's business and the activities of all its associated persons, a member must establish and maintain written procedures.⁴³ Paragraph (1) (General Requirements) under Rule 3110(b) (Written Procedures) provides that a member must establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

Currently, Rule 3110.17(b) expressly provides that consistent with a member's obligation under Rule 3110(b)(1), a member that elects to conduct each of its inspections in the specified calendar years remotely must amend or supplement its written supervisory procedures to provide for remote inspections that are reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with applicable FINRA rules. In addition, under Rule 3110.17(b), reasonably designed procedures for conducting remote inspection of offices or locations should include, among other things, a description of the methodology, including technologies permitted by the member, that may be used to conduct remote inspections. Further, such procedures should include the use of other risk-based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and

⁴³ See Rule 3110(a)(1); see generally Notice 99-45 and Regulatory Notice 18-15 (April 2018).

regulations, and of applicable FINRA rules.⁴⁴ To underscore the importance of Rule 3110(b)(1) in the context of the proposed pilot program, FINRA is proposing to add to the elements currently described under Rule 3110.17(b) an express provision that the firm must adopt written supervisory procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. In addition, a firm's written supervisory procedures should also include the factors considered in the risk assessment made for each applicable office or location pursuant to proposed Rule 3110.18(b).

D. Effective Supervisory System (Proposed Rule 3110.18(d))

FINRA is proposing to retain the terms of Rule 3110.17(c), without substantive change, in proposed Rule 3110.18(d). Similar to Rule 3110.17(c), proposed Rule 3110.18(d) would expressly reiterate the principle that the requirement to conduct inspections of offices and locations is one part of the member's overall ongoing obligation to have an effective supervisory system, and therefore a member must continue with its reviews of the activities and functions occurring at all offices and locations whether or not the member conducts inspections remotely. In addition, proposed Rule 3110.18(d) would provide that a member's remote inspection of an office or location would be held to the same standards for review applicable to on-site

⁴⁴ Offices or locations that may present a higher risk profile would include, for example, those that have associated persons engaging in activities that involve handling customer funds or securities, maintaining books and records as described under applicable federal securities laws and FINRA rules, order execution or other activities that may be more susceptible to higher risks of operational or sales practice wrongdoing, or have associated persons assigned to an office or location who may be subject to additional or heightened supervisory procedures.

inspections as set forth under Rule 3110.12.⁴⁵ Further, proposed Rule 3110.18(d) would provide that where a member's remote inspection of an office or location identifies any indicators of irregularities or misconduct (i.e., "red flags"), the member may need to impose additional supervisory procedures for that office or location, or may need to provide for more frequent monitoring or oversight of that office or location, or both, including potentially a subsequent physical, on-site visit on an announced or unannounced basis.

E. Documentation Requirement (Proposed Rule 3110.18(e))

In general, Rule 3110(c)(2) imposes various documentation requirements for inspections, including maintaining a written record of the date upon which each inspection is conducted. Currently, Rule 3110.17(d) requires supplemental documentation by a member that avails itself of the remote inspection option. The member must maintain and preserve a centralized record for each of calendar years specified in the supplementary material that separately identifies: (1) all offices or locations that had inspections that were conducted remotely; and (2) any offices or locations that the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in Rule 3110.17(c). A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection. FINRA is proposing to incorporate, without substantive change, the terms of Rule 3110.17(d) in proposed Rule 3110.18(e), but make two clarifying changes. One change would be to reference that the centralize record must

⁴⁵ See note 19, supra and accompanying text.

be for each of the “pilot years” (as defined in proposed Rule 3110.18(h)), and the other change would be to clarify that a member’s documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection, including whether an on-site inspection was conducted at such office.

F. Data and Information Collection Requirement (Proposed Rule 3110.18(f))

1. Data and Information (Proposed Rule 3118.18(f)(1))

As noted above, Rule 3110.17 was adopted in the midst of the pandemic and operationalized in an environment in which many offices and locations were closed to the public. FINRA believes that the formalized, uniform collection of data is critical to allow FINRA to meaningfully assess the effectiveness of remote inspections to help shape potential permanent amendments to Rule 3110(c) that would optimize an inspection program in the evolving workplace environment. FINRA believes having a pilot program for remote inspections with appropriate conditions, limitations and documentation requirements in an environment that is resettling into a hybrid workplace model would provide a clearer picture of the strengths and weaknesses of remote inspections, without compromising investor protection. Proposed Rule 3110.18(f) would impose upon firms a data and information collection requirement as a condition for participating in the pilot program. On a frequency not to exceed quarterly, participating firms would be required to collect and produce to FINRA, in a manner and format determined by FINRA, data consisting of separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations, consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110, for several categories, including: (1)

the total number of inspections—on-site and remote—completed during each calendar quarter;⁴⁶ (2) the number of those office or locations in each calendar quarter that were subject to an on-site inspection because of a “finding” (defined under proposed Rule 3110.18(f) as an item that led to any remedial action or was listed on the member’s inspection report);⁴⁷ (3) the number of locations for which a remote inspection was conducted in the calendar quarter that identified a finding, the number of findings, and a list of the most significant findings;⁴⁸ and (4) the number of locations for which a on-site inspection was conducted in the calendar quarter that identified a finding, the number of findings, a list of the most significant findings.⁴⁹ In addition, firms would be required to provide FINRA their written supervisory procedures for remote inspections that account for: (1) escalating significant findings; new hires; supervising brokers with a significant history of misconduct; and outside business activities and “doing business as” (or DBA) designations.⁵⁰ Firms would be required to provide FINRA with a copy of these written supervisory procedures alongside the first delivery of the data points described above, and any subsequent amendments to such procedures for remote inspections.⁵¹

⁴⁶ See proposed Rule 3110.18(f)(1)(A), (B) and (C).

⁴⁷ See proposed Rule 3110.18(f)(1)(D).

⁴⁸ See proposed Rule 3110.18(f)(1)(E).

⁴⁹ See proposed Rule 3110.18(f)(1)(F).

⁵⁰ See proposed Rule 3110.18(f)(1)(G)(i) through (iv).

⁵¹ See proposed Rule 3110.18(f)(1)(G).

2. Additional Data and Information for Pilot Year 1 (Proposed Rule 3110.18(f)(2))

Proposed Rule 3110.18(f)(2) would address the additional data and information requirements for Pilot Year 1 (as defined under proposed Rule 3110.18(h)), if such year covers a period that is less than a full calendar year. In such case, a member that elects to participate in the proposed pilot program would be required to collect the following data and information and provide such data and information to FINRA (in a manner and format FINRA determines) no later than December 31 of such first Pilot Year. For items (1) through (3) below, a member would be required to provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110: (1) the number of locations with an inspection completed during the full calendar year of the first Pilot Year; (2) the number of locations in item (1) that were inspected remotely during the full calendar year of the first Pilot Year; and (3) the number of locations in item (1) that were inspected on-site during the full calendar year of the first Pilot Year. This additional data and information would provide FINRA the ability to capture, in the aggregate, complete inspection counts—total number of Rule 3110(c)(1) inspections (remote and on-site)—for the entire calendar year in addition to the more detailed data and information requirements under proposed Rule 3110.18(f)(1).

3. Written Policies and Procedures (Proposed Rule 3110.18(f)(3))

Proposed Rule 3110.18(f)(3) would also remind firms of the general requirement to establish, maintain and enforce written policies and procedures that are reasonably designed to comply with the data and information collection, and transmission requirements of the proposed pilot program.

4. Remote Inspections Pilot Program Participation (Proposed Rule 3110.18(g))

Proposed Rule 3110.18(g) would set forth the manner in which a firm would notify FINRA of the firm's election to participate in the proposed pilot program and to withdraw from it. The proposed rule would provide that FINRA may, in exceptional cases and where good cause is shown, waive the applicable timeframes described below for the required opt-in or opt-out notices.

Proposed Rule 3110.18(g) would require a firm, at least five calendar days before the beginning of such Pilot Year, to provide FINRA an "opt-in notice" in the manner and format determined by FINRA. By providing such opt-in notice to FINRA, the firm agrees to participate in the proposed pilot program for the duration of such Pilot Year and to comply with the requirements of Rule 3110.18.⁵² A firm that provides the opt-in notice for a Pilot Year would be automatically deemed to have elected and agreed to participate in the Remote Inspections Pilot Program for subsequent Pilot Years (i.e., Pilot Year 2, Pilot Year 3, and Pilot Year 4, if applicable) until the pilot program expires. Further, proposed Rule 3110.18(g) would describe the notice requirement for a firm to withdraw from the proposed pilot program. A firm would be required to provide FINRA with an "opt-out notice" at least five calendar days before the end of the then current Pilot Year.

By way of example, a firm that provides FINRA an opt-in notice on June 26 to join Pilot Year 1 that begins on July 1 would be automatically deemed to continue participating in Pilot Year 2 unless the firm provides FINRA the required opt-out notice

⁵² A firm that participates in a Pilot Year would be committed to complying with the terms of proposed Rule 3110.18 for that Pilot Year.

no later than December 26 of Pilot Year 1. To continue with this example, a firm that was automatically deemed to participate in Pilot Year 2 and determines in mid-Pilot Year 2 that it does not want to automatically continue into Pilot Year 3 could elect to withdraw from Pilot Year 3 if it provides FINRA an opt-out notice at least five calendar days before the end of Pilot Year 2. However, because Pilot Year 2 is already underway, the firm would be required to complete Pilot Year 2 in accordance with proposed Rule 3110.18.

FINRA believes that this proposed operational aspect of the program would not only establish a cohesive process in which firms and FINRA may manage program participation but also lend some continuity in data and information collection that would support FINRA's assessment and evaluation of the experiences of pilot participants.

5. Definitions (Proposed Rule 3110.18(h))

Proposed Rule 3110.18(h) would set forth the meanings underlying "Pilot Year" to explain the duration of the proposed pilot program. Under proposed Rule 3110.18(h), a "Pilot Year" would mean the following: (1) Pilot Year 1 would be the period beginning on the effective date of the proposed pilot program and ending on December 31 of the same year; (2) Pilot Year 2 would mean the calendar year period following Pilot Year 1, beginning on January 1 and ending on December 31; and (3) Pilot Year 3 would mean the calendar year period following Pilot Year 2, beginning on January 1 and ending on December 31. Finally, if applicable, where Pilot Year 1 covers a period that is less than a full calendar year, then Pilot Year 4 would mean the period following Pilot Year 3, beginning on January 1 and ending on a date that is three years after the effective date.

6. Failure to Satisfy Conditions (Proposed Rule 3110.18(i))

Proposed Rule 3110.18(i) would address a situation in which a firm fails to satisfy terms of the proposed pilot program. The proposed paragraph would provide that a firm that fails to satisfy the conditions of Rule 3110.18, including the requirement to timely collect and submit the data and information to FINRA as set forth in proposed Rule 3110.18(f), would be ineligible to participate in the pilot program and must conduct on-site inspections of each office and location on the required cycle in accordance with Rule 3110(c).

7. Sunset of Rule 3110.17 (Proposed Rule 3110.18(j))

Proposed Rule 3110.18 would expressly account for the possibility that the proposed pilot program becomes effective while Rule 3110.17 is in effect to avoid overlapping provisions. Proposed paragraph (j) would provide that if Rule 3110.17 has not already expired by its own terms, it would automatically sunset on the effective date of proposed Rule 3110.18.

Consistent with the principles set forth in prior guidance, FINRA expects members to establish reasonably designed inspection programs. The proposed pilot program for remote inspections does not alter the core obligation of a member firm to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.⁵³ As part of the inspection planning process, FINRA expects members to continue with their ongoing supervision, including risk analysis of the activities and functions occurring at all offices or locations. While the

⁵³ See Rule 3110(a).

option to conduct remote inspections provides greater choice in how to effectively supervise some offices or locations, a member must continue to consider the factors described in Rule 3110.12, along with the activities taking place there. This analysis may require the member to conduct a physical, on-site inspection of an office or location. Where there are indications of problems or red flags at any office or location, FINRA expects members to investigate them as they would for any other office or location subject to Rule 3110(c), which may include an unannounced, on-site inspection of the office or location. FINRA is committed to diligently monitoring the impacts of remote inspections on a firms' overall supervisory systems and reviewing the data over the life of the proposed pilot program to assess how firms apply the flexibility provided by the pilot program while maintaining an effective supervisory program.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁵⁴ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The terms of the proposed voluntary, three-year remote inspection pilot program, while based largely on the terms of Rule 3110.17, which has been operational since the latter part of 2020 and is set to automatically sunset on December 31, 2022, would

⁵⁴ 15 U.S.C. 78o-3(b)(6).

include important safeguards that would require individual risk assessments of each office, supplemental written supervisory procedures related to remote inspections, documentation requirements and obligations to share data with FINRA to allow for assessment of the pilot program. The proposed rule change is intended to provide firms that are transitioning to a hybrid work environment the option to conduct remote inspections of their offices and locations, subject to specified conditions, while maintaining effective supervision. FINRA believes that the proposed pilot program would provide FINRA the appropriate amount of time and population sample to better evaluate the use of remote inspections in the unfolding office work environment. FINRA believes the proposed pilot program, with the proposed safeguards and controls, will provide firms more flexibility to adapt to changing work conditions. The proposed pilot program would aid in FINRA's assessment of the effectiveness of a flexible remote inspection option and its utility in an environment that is increasingly moving to hybrid workplace models, without compromising investor protection.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to

the current baseline, and the alternatives FINRA considered in assessing how best to meet FINRA's regulatory objectives.

1. Regulatory Need

The proposed pilot program would serve two purposes. First, it would mitigate potential disruptions to the hybrid work arrangements that have developed during the pandemic. In particular, for participating members, the proposed pilot program would limit the increase in aggregate inspection costs, and the resulting incentive to reduce the number and type of work locations, that would occur when temporary relief provided during the pandemic expires.⁵⁵ The proposed pilot program would not eliminate the need for such adjustments, but it would allow member firms to focus their on-site inspections on riskier locations.

The proposed pilot program would also allow FINRA to assess the benefits and costs of allowing some element of remote inspection of branch offices and non-branch locations, under specified conditions, in the post-pandemic world. FINRA would obtain information from participating members on certain elements of the risk-based approach that they implement, the type and frequency of inspections, and certain outcomes

⁵⁵ According to the April Survey of Working Arrangements and Attitudes (SWAA), post-COVID, many employers are planning to allow employees to work from home between two and three days per week. See Jose Maria Barrero, Nicholas Bloom & Steven J. Davis, SWAA April 2022 (April 11, 2022), https://wfhrsearch.com/wp-content/uploads/2022/04/WFHRsearch_updates-April-2022.pdf. The number of expected work-from-home days post-pandemic has been increasing steadily since the January 2021 survey. The SWAA is monthly survey with respondents that are working-age persons in the United States that had earnings of at least \$20,000 in 2019. Further details about this survey can be found in <https://wfhrsearch.com>.

conditional on the type and frequency of inspections, as well as the type of office or location inspected.

2. Economic Baseline

The economic baseline for the proposed rule change includes both current and foreseeable workforce arrangements and business practices, including those that were first developed during the pandemic and have been modified since. In particular, the economic baseline includes the innovations, and investments in communication and surveillance technology, that have supported and continue to support supervision in the remote work environment.⁵⁶ These innovations and investments were developed during the temporary relief allowing remote inspections in Rule 3110.17, and the temporary suspension of the requirement to submit branch office applications on Form BR for new office locations provided in Notice 20-08. The baseline includes the scheduled expiration of Rule 3110.17 on the effective date of the proposed Rule 3110.18; and, in order to provide a full accounting of the likely effects of the proposed rule change, the analysis also assumes that, going forward, the temporary suspension of the above requirement is no longer in effect. FINRA expects that numerous additional office locations would then need to be registered, greatly expanding the number of inspections, and all inspections would then need to be conducted on-site.

⁵⁶ The pandemic propelled increased reliance on technology solutions in the remote work environment. A Thompson Reuters survey of compliance and risk practitioners shows a 70% increase in the reliance on technological solutions and 30% of respondents expected increases in the budget for RegTech solutions, specifically. See Thompson Reuters, FinTech, RegTech and the Role of Compliance 2021, <https://legal.thomsonreuters.com/content/dam/ewp-m/documents/legal/en/pdf/reports/fintech-regtech-and-the-role-of-compliance-in-2021.pdf>.

As of April 30, 2022, FINRA's membership included 3,365 firms with 151,463 registered branch offices.⁵⁷ Of these branch offices, 18,290 (12%) are OSJs subject to an annual inspection requirement. The remaining 133,173 branch locations are non-OSJ branch offices subject to an inspection requirement at least annually or every three years. In addition, according to FINRA estimates, there are more than 66,054 non-branch locations, of which 37,290 are private residences.⁵⁸ A non-branch location must be inspected on a periodic schedule, presumed to be at least every three years. These data may be affected by the temporary relief from certain requirements to update Form U4 and to submit Form BR provided in Notice 20-08. FINRA estimates that member firms conduct approximately 84,700 inspections per year.

FINRA adopted temporary Rule 3110.17 in late 2020 and the temporary rule has been extended twice since.⁵⁹ Hence, as of June 2022, member firms have been able to conduct remote inspections for 18 months. FINRA staff considered findings from FINRA's examination of member firms and their branch locations that took place in between 2018 and 2021. This preliminary review found no significant departures relative to pre-pandemic examination results.⁶⁰

⁵⁷ This count excludes firms with membership pending approval, and withdrawn or terminated from membership.

⁵⁸ Non-branch locations do not have to be registered with FINRA. The estimates for non-branch locations, including those that are also private residences, are obtained by reviewing Form U4. There may be some double counting of non-branch locations if members record the address differently on more than one Form U4 (e.g., use "St." on one and "Street" on another).

⁵⁹ See notes 7 and 33, supra.

⁶⁰ FINRA examinations generally review member activities for the year preceding the examination, and the vast majority of examinations takes place during the first 10 months of the calendar year. Examinations check for compliance with federal

3. Economic Impacts

As discussed above, absent the proposed rule change, FINRA expects that numerous additional office locations will need to be registered, greatly expanding the number of inspections, and all inspections would then need to be conducted on site. The economic impacts of these changes would be mitigated by the proposed rule change for firms that choose to participate in the pilot program.⁶¹

Participants in the pilot program would be expected to take a risk-based approach to conducting remote inspections. A firm that does not conduct a remote inspection for an office or location must conduct an on-site inspection of that office or location on the required cycle and remains subject to the other requirements of Rule 3110(c). A firm that

laws, rules and regulations; the specific areas examined in a firm are based on the risk profile of the firm. FINRA publishes an annual summary of key observations and best practices across all examinations. See the published reports at <https://www.finra.org/rules-guidance/key-topics/finra-examination-risk-monitoring-programs#guidance>. Due to this time lag in FINRA examinations, findings may reflect decisions about remote inspections made by members preceding examinations up to 12 months. Hence, most FINRA examinations in 2020 will reflect member planning undertaken prior to the adoption of Rule 3110.17. Conversely, 66% of FINRA examinations for calendar 2021 have not been finalized. In addition, FINRA examinations of member firms and their activities are risk-based. Given the focus on higher risk firms and some variations in the areas of focus in examinations, year-on-year comparisons should be treated with caution.

⁶¹ Separately, FINRA has filed a proposed rule change to establish a Residential Supervisory Location (“RSL”), a new non-branch location, that would, relative to the baseline, reduce the number of inspections that members with RSLs would need to conduct in a year. See Securities Exchange Act Release No. 95379 (July 27, 2022) (Notice of Filing of File No. SR-FINRA-2022-019). For member firms with locations that would meet the proposed definition of an RSL, the aggregate cost savings from choosing to participate in the proposed pilot program would be lower if the RSL proposal were in place because the cost savings from remote inspections would accrue over fewer inspections. The qualitative impacts of the proposed pilot program, however, are similar whether the proposed definition of an RSL is adopted or not.

chooses to participate in the pilot program (assuming that it is not otherwise ineligible from participating) would also be required to provide FINRA with certain data and other information about the risk-based approach that they implement, the type and frequency of inspections, and certain outcomes conditional on the type and frequency of inspections.

Anticipated Benefits

The benefit to firms of choosing to participate in the pilot program, in an improved health environment, would result from limiting the increase in travel costs and lost productivity due to time spent during travel and in the on-site inspection. On-site visits have material costs from travel expenses and additional staff time. A system of risk-based on-site and remote inspections will allow firms to more efficiently deploy compliance resources and to use an on-site component only when appropriate.

Firms as well as investors may benefit if remote inspections provide new flexibility in the design of inspection teams. For example, remote inspections may facilitate the development of specialized inspection staff that are deployed over more inspections, for shorter periods of time, in a targeted way. This option may especially benefit diversified member firms with a variety of product offerings. Remote inspections can also facilitate the use of inspections that target a particular area of focus in a member firm's business across all branches of the member firm.

The proposed rule change may also support the competitiveness of the broker-dealer industry for individuals who seek professional positions in compliance.⁶² The

⁶² See note 56, *supra*. See also Jose Maria Barrero, Nicholas Bloom & Steven J. Davis, *Why Working from Home Will Stick* (NBER Working Paper 28731, April 2021), <https://wfhresearch.com/wp-content/uploads/2021/04/w28731-3-May-2021.pdf>, who point to a lasting effect of the pandemic on work arrangements, in particular for those with higher education and earnings; and Alexander Bick,

expectation of workplace flexibility and remote work by such individuals may lead them away from the broker-dealer industry if other segments of financial services or professional occupations offer more flexible workforce arrangements, with regulatory frameworks that offer more discretion in how the supervision is conducted.⁶³ Even prior to the pandemic, the scope of on-site inspections had been much reduced due to technological surveillance solutions and centralization of books and records. The proposed pilot would support continued adoption and innovation in technological solutions and reductions in the cost of these solutions.

Participants in the proposed pilot program would provide FINRA with periodic (not to exceed quarterly) data on the frequency and type of inspections (on-site or remote), counts of findings from inspections subdivided by category of office or location, qualitative information about these findings, and certain information about the written supervisory procedures for remote inspections they are required to have.⁶⁴ Depending on the number and types of firms that participate in the proposed pilot program, this data may allow FINRA to identify differences in risks between remote versus on-site inspection, both conditional on the observable characteristics and policies of firms and

Adam Blandin & Karel Mertens, Work from Home Before and After the COVID-19 Outbreak, (Working Paper, February 2022), https://karelmertenscom.files.wordpress.com/2022/02/wfh_feb17_2022_paper.pdf, who find consistent results, with a higher adoption rate of work from home jobs in Finance and Insurance, relative to other industries, reflected in Figure 10.

⁶³ For example, Advisers Act Rule 206(4)-7 does not require Registered Investment Advisers to conduct in-person inspections or reviews of its offices or personnel.

⁶⁴ In addition, if the effective date of the rule is such that the first year of the pilot program covers a period less than a full calendar year, participating firms would be required to provide, the data and information specified in proposed Rule 3110.18(f)(2).

overall, the extent of variation in these risks across firms and firm characteristics, and factors associated with very high or low risks. The proposed pilot program has the potential to yield a more thorough collection of sensitive information in a structured manner than voluntary submissions or a survey of FINRA members could provide. This data will be useful both for monitoring for risks as the pilot proceeds and, with sufficient participation, for developing a balanced assessment of the potential impact of permitting further remote inspection.

Anticipated Costs

Participation in the proposed pilot program is voluntary, and the proposed rule change provides firms with an additional method for complying with certain supervisory requirements without removing other methods of compliance. Eligible pilot participants will therefore participate in the pilot program only if doing so is beneficial to their operations relative to complying with current Rule 3110. The cost of complying with the requirements of the proposed pilot program is a factor in this decision. These costs include conducting risk-based analyses for inspections and providing aggregated data on findings to FINRA. The data request in particular may require more standardization and aggregation of inspection findings than some member firms typically conduct. The data request may also not use the same terms or formats used by compliance officers for reporting and tracking inspection findings. Firms may need to develop new written supervisory procedures and new trainings for compliance staff to ensure that all required data is accurate and compiled and submitted to FINRA in a timely manner. Firms will incur new ongoing costs both for compliance and monitoring for compliance.

Supervision and inspections are intended to identify not only the activities that violate member procedures or FINRA rules but also poor practices that might ultimately allow for such violations. FINRA recognizes that remote inspections may be less likely to identify such practices or activities as on-site inspections. FINRA believes that risks to member firms and investors from remote inspections are mitigated by the proposed requirements to have written supervisory procedures for remote inspections, the proposed requirement to conduct and document risk assessments, the proposed limitations on the firms and locations that would be eligible to participate in the proposed pilot program, and the technology already employed for day-to-day supervision. In addition, FINRA will continue to closely monitor the outcomes of examinations during the pilot program period.

4. Alternatives Considered

The proposed pilot program would continue for three years. FINRA staff considered alternative durations for the program. FINRA members firms vary by business model and organizational structure, so a shorter program is less likely to yield enough data on inspection findings to allow for meaningful comparisons between on-site and remote inspection regimes across members. In addition, inspections are typically planned by members well ahead of time, so some members may not implement the requirements of the program until well into the duration of the pilot program. It may also help firms and the policy development process if FINRA had enough data to meaningfully evaluate well ahead of the expiration of the pilot program.

FINRA staff also considered a proposed pilot program that would not exclude certain firms, like restricted firms, from participating in the program. These additional

restrictions will limit the availability of the pilot program as well as the potential learnings from the program. As a result, the same restrictions may ultimately need to be carried over into any ongoing program of risk-based examinations. The exclusion of such firms, however, should reduce any risk of customer harm from not having on-site inspections.⁶⁵

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

⁶⁵ See Zachary T. Kowaleski, Andrew G. Sutherland & Felix W. Vetter, Supervisor Influence on Employee Financial Misconduct (Working Paper, July 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3646617. This paper presents evidence that could be interpreted as supportive of the exclusions based on misconduct and lack of experience.

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2022-021 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2022-021. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only

information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2022-021 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁶⁶

Jill M. Peterson
Assistant Secretary

⁶⁶ 17 CFR 200.30-3(a)(12).

EXHIBIT 5

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

3100. SUPERVISORY RESPONSIBILITIES

3110. Supervision

(a) through (f) No Change.

• • • Supplementary Material: -----

.01 through .17 No Change.

.18 Remote Inspections Pilot Program

(a) Scope of Pilot. This Supplementary Material establishes a pilot program ("Remote Inspections Pilot Program") with respect to the required inspection of offices of supervisory jurisdiction, branch offices and non-branch locations pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110. The Remote Inspections Pilot Program shall cover required inspections of such offices or locations for a period of three years starting on [insert effective date] ("pilot period"), and such pilot period shall expire on [insert date that is three years after effective date]. If the pilot period is not extended or Rule 3110.18, as may be amended, is not approved as permanent by the Commission, this Supplementary Material will automatically sunset on [insert date that is three years after effective date]. Members will not be able to avail themselves of the Remote Inspections Pilot Program after such date.

(b) Use of Remote Inspections

(1) Subject to paragraph (b)(2) of this Supplementary Material, each member obligated to conduct an inspection of an office or location during the

pilot period pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110 may, subject to the requirements of this Rule 3110.18, elect to conduct the applicable inspection remotely, without necessarily an on-site visit for an office or location, when the member reasonably determines that the purposes of this Supplementary Material can be accomplished by conducting such required inspection remotely. Prior to electing a remote inspection for an office or location, rather than an on-site inspection, the firm must develop a reasonable risk-based approach to using remote inspections, and conduct and document a risk assessment for that office or location. The assessment must document the factors considered, including the factors set forth in Rule 3110.12 and must take into account any higher risk activities that take place or higher risk associated persons that are assigned to that location. A member that is not eligible to conduct remote inspections in accordance with paragraph (b)(2) of this Supplementary Material must conduct an on-site inspection of that office or location on the required cycle. Notwithstanding Rule 3110.18, a member shall remain subject to the other requirements of Rule 3110(c).

(2)(A) A member shall not be eligible to conduct remote inspections of any of its offices or locations in accordance with this Supplementary Material if any time during the period of this Remote Inspections Pilot Program, the member is or becomes:

(i) designated as Restricted Firm under Rule 4111; or

(ii) designated as a Taping Firm under Rule 3170.

(B) A specific office or location of a member shall not be eligible for a remote inspection in accordance with this Supplementary Material if any time during the period of this Remote Inspections Pilot Program, an associated person at such office or location is or becomes:

(i) subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or state regulatory agency;

(ii) statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a mandatory heightened supervisory plan under paragraph (b)(2)(B)(i) of this Supplementary Material or otherwise as a condition to approval or permission for such association;

(iii) subject to Rule 1017(a)(7) as a result of one or more associated persons at such location; or

(iv) one or more associated persons at such location has an event in the prior three years that required a "yes" response to any item in Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4.

(c) Written Supervisory Procedures for Remote Inspections. Consistent with a member's obligation under Rule 3110(b)(1), a member that elects to participate in the Remote Inspections Pilot Program must adopt written supervisory procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and

achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Reasonably designed procedures for conducting remote inspections of offices or locations should include, among other things: (1) a description of the methodology, including technology, that may be used to conduct remote inspections; (2) the factors considered in the risk assessment made for each applicable office or location pursuant to paragraph (b) of this Supplementary Material; and (3) the use of other risk-based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.

(d) Effective Supervisory System. The requirement to conduct inspections of offices and locations is one part of the member's overall obligation to have an effective supervisory system and therefore the member must continue with its ongoing review of the activities and functions occurring at all offices and locations, whether or not the member conducts inspections remotely. A member's use of a remote inspection of an office or location will be subject to the same standards for review as set forth under Rule 3110.12. Where a member's remote inspection of an office or location identifies any indicators of irregularities or misconduct (i.e., "red flags"), the member may need to impose additional supervisory procedures for that office or location or may need to provide for more frequent monitoring of that office or location, including potentially a subsequent on-site visit on an announced or unannounced basis.

(e) Documentation Requirement. A member must maintain and preserve a centralized record for each of the Pilot Years specified in this Remote Inspections Pilot Program that separately identifies: (1) all offices or locations that were inspected

remotely; and (2) any offices or locations for which the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in Rule 3110.18(d). A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection, including whether an on-site inspection was conducted at such office.

(f) Data and Information Collection Requirement

(1) Data and Information. A member that elects to participate in the Remote Inspections Pilot Program shall collect the following data and information and provide such data and information to FINRA, on a periodic basis (not to exceed quarterly), and in the manner and format determined by FINRA. For items (A) through (F) below, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110; and the term "findings" means items that led to any remedial action or were listed on an inspection report by the member:

(A) number of locations with an inspection completed during each calendar quarter;

(B) number of locations in item (A) that were inspected remotely;

(C) number of locations in item (A) that were inspected on-site;

(D) number of locations in item (C) that were inspected on site because of a finding;

(E) number of locations in item (B) where findings were identified, the number of those findings and a list of the most significant findings;

(F) number of locations in item (C) where findings were identified, the number of those findings and a list of the most significant findings; and

(G) requirements of the Written Supervisory Procedures for Remote Inspections in each of the four areas below. This information should be provided with the first delivery of data made pursuant to this Rule 3110.18(f), and thereafter with the first delivery of such data made after any amendments to the Written Supervisory Procedures for Remote Inspections:

(i) procedures for escalating significant findings;

(ii) procedures for new hires;

(iii) procedures for supervising brokers with a significant history of misconduct; and

(iv) procedures related to outside business activities (OBAs) and doing business as (DBA) designations.

(2) Additional Data and Information for Pilot Year 1. In addition to the information set forth in paragraph (f)(1) of this Supplementary Material, if Pilot Year 1 covers a period that is less than a full calendar year, a member that elects to participate the Remote Inspections Pilot Program shall collect the following data and information and provide such data and information to FINRA

no later than December 31 of such first Pilot Year in the manner and format determined by FINRA. For items (A) through (C) below, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110:

(A) the number of locations with an inspection completed during the full calendar year of the first Pilot Year;

(B) the number of locations in item (A) that were inspected remotely during the full calendar year of the first Pilot Year; and

(C) the number of locations in item (A) that were inspected on-site during the full calendar year of the first Pilot Year.

(3) Written Policies and Procedures. A member shall establish, maintain and enforce written policies and procedures that are reasonably designed to comply with the data and information collection, and transmission requirements of paragraph (f) of this Supplementary Material.

(g) Remote Inspections Pilot Program Participation. A member that elects to participate in the Remote Inspections Pilot Program for any Pilot Year shall, at least five calendar days before the beginning of such Pilot Year, provide FINRA an "opt-in notice" in the manner and format determined by FINRA. By providing such opt-in notice to FINRA, the member agrees to participate in the Remote Inspections Pilot Program for the duration of such Pilot Year and to comply with the requirements of Rule 3110.18. A member that provides an opt-in notice for a Pilot Year shall be automatically deemed to have elected and agreed to participate in the Remote Inspections Pilot Program for

subsequent Pilot Years until the Remote Inspections Pilot Program expires. A member that elects to withdraw from subsequent Pilot Years (i.e., Pilot Year 2, Pilot Year 3, and Pilot Year 4, if applicable) shall, at least five calendar days before the end of the then current Pilot Year, provide FINRA with a "opt-out notice" in the manner and format determined by FINRA. FINRA may, in exceptional cases and where good cause is shown, waive the applicable timeframes for the required opt-in or opt-out notices.

(h) Definitions. For purposes of this Supplementary Material, the term "Pilot Year" shall mean the following:

(1) Pilot Year 1 is the period beginning on [insert effective date] and ending on December 31 of the same year;

(2) Pilot Year 2 means the calendar year period following Pilot Year 1, beginning on January 1 and ending on December 31;

(3) Pilot Year 3 means the calendar year period following Pilot Year 2, beginning on January 1 and ending on December 31; and

(4) If applicable, where Pilot Year 1 covers a period that is less than a full calendar year, then Pilot Year 4 means the period following Pilot Year 3, beginning on January 1 and ending on [insert date that is three years after effective date].

(i) Failure to Satisfy Conditions. A member that fails to satisfy the conditions of Rule 3110.18, including the requirement to timely collect and submit the data and information to FINRA as set forth in paragraph (f) of this Supplementary Material, shall be ineligible to participate in the Remote Inspections Pilot Program and must conduct on-

site inspections of each office and location on the required cycle in accordance with Rule 3110(c).

(j) **Sunset of Rule 3110.17.** If Rule 3110.17 has not already expired by its own terms, Rule 3110.17 will automatically sunset on [insert effective date].

.19 Reserved.

* * * * *

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 40

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. * SR 2022 - * 021

Amendment No. (req. for Amendments *) 1

Filing by Financial Industry Regulatory Authority

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial *	Amendment *	Withdrawal	Section 19(b)(2) *	Section 19(b)(3)(A) *	Section 19(b)(3)(B) *
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Pilot	Extension of Time Period for Commission Action *	Date Expires *	Rule
<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>	<input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(4) <input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(5) <input type="checkbox"/> 19b-4(f)(3) <input type="checkbox"/> 19b-4(f)(6)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) *

☐

Section 806(e)(2) *

☐Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 3C(b)(2) *☐

Exhibit 2 Sent As Paper Document

☐

Exhibit 3 Sent As Paper Document

☐**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name *	<input type="text" value="Sarah"/>	Last Name *	<input type="text" value="Kwak"/>
Title *	<input type="text" value="Associate General Counsel"/>		
E-mail *	<input type="text" value="sarah.kwak@finra.org"/>		
Telephone *	<input type="text" value="(202) 728-8471"/>	Fax	<input type="text"/>

Signature

Pursuant to the requirements of the Securities Exchange of 1934, Financial Industry Regulatory Authority has duty caused this filing to be signed on its behalf by the undersigned thereunto duty authorized.

Date

(Title *)

By

(Name *)

Kosha DalalDigitally signed by Kosha Dalal
2022.12.15 16:13:22

-05'00'

NOTE: A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFT website.

Form 19b-4 Information *

Add	Remove	View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

Add	Remove	View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A - Notice of Proposed Rule Change, Security-Based Swap Submission, or Advanced Notice by Clearing Agencies *

Add	Remove	View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2- Notices, Written Comments, Transcripts, Other Communications

Add	Remove	View

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

☐

Exhibit Sent As Paper Document

Exhibit 3 - Form, Report, or Questionnaire

Add	Remove	View

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

☐

Exhibit Sent As Paper Document

Exhibit 4 - Marked Copies

Add	Remove	View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add	Remove	View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change

Partial Amendment

Add	Remove	View
FINRA-2022-021 Partial A-1.docx		
FINRA-2022-021 Partial A-1 Exhibit 4.		
FINRA-2022-021 Partial A-1 Exhibit 5.		

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

On July 28, 2022, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change, SR-FINRA-2022-021, to amend FINRA Rule 3110 (Supervision) to adopt new Supplementary Material .18 (Remote Inspections Pilot Program) that would establish a voluntary, three-year remote inspection pilot program to allow member firms to fulfill their obligation under Rule 3110(c) (Internal Inspections) by conducting inspections of some or all branch offices and locations remotely without an on-site visit to such office or location, subject to specified terms (“Initial Proposal”).

The Commission published the Initial Proposal for public comment in the Federal Register on August 15, 2022 and the comment period closed on September 6, 2022.¹ For this first comment period, the Commission received 28 comment letters in response to the Initial Proposal, of which 24 comment letters expressed support for its overall intent.² On September 23, 2022, FINRA consented to an extension of the time period for SEC action on the proposed rule change to November 11, 2022.³ On November 9, 2022, FINRA filed with the SEC a letter stating it was still considering the comments to the Initial Proposal, and anticipates submitting a response to comments and amendments to the Initial Proposal in the near future.⁴ On November 10, 2022, the Commission instituted proceedings to determine whether to approve or disapprove the proposed rule change.⁵ The second comment period closed on December 7, 2022. In response to this second comment period, the SEC received four comment letters.⁶ CAI and FSI, which

¹ See Securities Exchange Act Release No. 95452 (August 9, 2022), 87 FR 50144 (August 15, 2022) (Notice of Filing of File No. SR-FINRA-2022-021).

² See Attachment A for the list of commenters. The 28 comment letters consist of 25 unique comment letters, one supplemental comment letter from LPL and two supplemental comment letters from SIFMA.

³ See Letter from Sarah Kwak, Associate General Counsel, FINRA, to Daniel Fisher, Division of Trading and Markets, SEC, dated September 23, 2022.

⁴ See Letter from Sarah Kwak, Associate General Counsel, FINRA, to Vanessa Countryman, Secretary, SEC, dated November 9, 2022.

⁵ See Securities Exchange Act Release No. 96297 (November 10, 2022), 87 FR 68774 (November 16, 2022) (Order Instituting Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2022-021).

⁶ See Letter from Eric Arnold & Clifford Kirsch, Eversheds Sutherland (US) LLP for the Committee of Annuity Insurers, to Secretary, SEC, dated December 7, 2022 (“CAI II”); Letter from David T. Bellaire, Esq., Executive Vice President & General Counsel, Financial Services Institute, to Secretary, SEC, dated December 7, 2022 (“FSI II”); Letter from Andrew Hartnett, President, North American Securities Administrators Association, Inc., to Sherry R. Haywood, Assistant Secretary, SEC, dated December 7, 2022 (“NASAA II”); and Letter from Hugh

previously submitted supportive comment letters addressing the Initial Proposal,⁷ reaffirmed their overall support.⁸ NASAA and PIABA, each of which also previously submitted a comment letter in opposition to the Proposal,⁹ reaffirmed their opposition.¹⁰

FINRA is submitting by separate letter its response to comments on the proposed rule change contemporaneously with this Partial Amendment No. 1.¹¹ As FINRA explained in more detail in that Response to Comments, the majority of commenters expressed strong support for the overall intent of the Initial Proposal, and four commenters were critical of the Initial Proposal.¹²

As detailed in the Response to Comments, these commenters expressed concerns relating to: the adequacy and scope of the proposed pilot program's controls—the exclusions and conditions—to address higher-risk conduct; the identification of technologies firms would use to conduct their inspections remotely; the fundamental change to the approach of supervision; monitoring for pilot program compliance; and the lack of data to fully support the effectiveness of remote inspections.

In light of the comment letters, with this Partial Amendment No. 1, FINRA is proposing to amend proposed Supplementary Material .18 to Rule 3110 to:

- (1) add specific risk criteria that a member must consider in making its risk-based evaluation of an office or location;
- (2) expand the list of exclusions that would make a member ineligible to participate in the proposed pilot program;
- (3) expand the list of exclusions that would make a specific office or location of a member ineligible for a remote inspection;

D. Berkson, President, Public Investors Advocate Bar Association, to Vanessa Countryman, SEC, dated December 7, 2022 (“PIABA II”).

⁷ See note 2, supra.

⁸ See CAI II, FSI II.

⁹ See note 2, supra.

¹⁰ See NASAA II, PIABA II.

¹¹ See Letter from Kosha Dalal, Vice President and Associate General Counsel, FINRA, to Vanessa Countryman, Secretary, SEC, dated December 15, 2022 (“Response to Comments”).

¹² See Cornell, NASAA I, PIABA I, SJU. See also NASAA II, PIABA II.

- (4) add express conditions that a member must satisfy to be eligible to conduct remote inspections of any of its offices or locations;
- (5) add express conditions that a specific office or location of a member must satisfy to be eligible for a remote inspection; and
- (6) add a new provision to allow FINRA to make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the proposed pilot program if a member fails to comply with the requirements of Rule 3110.18.

With this Partial Amendment No. 1, FINRA is including Exhibit 4, which reflects changes to the text of the proposed rule change pursuant to this Partial Amendment No. 1, marked to show the changes to the text as proposed in the Initial Proposal, and Exhibit 5, which reflects all proposed changes to the current rule text, as amended by this Partial Amendment No. 1.

Proposed Additional Risk Assessment Criteria

In the Initial Proposal, FINRA proposed requiring that a firm, prior to electing a remote inspection for an office or location rather than an on-site inspection, must develop a reasonable risk-based approach to using remote inspections, and conduct and document a risk assessment for that office or location. The assessment must document the factors considered, including the factors set forth in Rule 3110.12 (Standards for Reasonable Review) and take into account any higher risk activities that take place or higher risk associated persons that are assigned to that location.

In light of concerns raised by commenters that a firm might not appropriately consider certain higher risk criteria in conducting its risk assessment, FINRA is proposing to add new paragraph (b)(2) to proposed Rule 3110.18 that would provide a non-exhaustive list of factors that a firm must consider and document. Specifically, the proposed new paragraph would provide that in conducting a risk assessment for each office or location, a member would be required to consider, among other things: (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. In addition, proposed new paragraph (b)(2) would further provide that consistent with Rule 3110.12, members should conduct on-site inspections or make more frequent use of unannounced, on-site inspections for high-risk locations or where there are "red flags."

FINRA expects a firm to carefully consider the proposed factors listed above and Rule 3110.12 for the risk assessment. The outcome of such assessment may raise red flags that should prompt a firm to consider, among other things, inspecting, remotely or

on-site, its offices or locations more frequently than the schedule set forth under Rule 3110(c)(1) (on an announced or unannounced basis). Moreover, FINRA notes that Rule 3130 (Annual Certification of Compliance and Supervisory Processes) requires member firms to have processes to establish, maintain, review, test, and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable FINRA rules, Municipal Securities Rulemaking Board rules, and federal securities laws and regulations. FINRA expects firms to consider Rule 3110.18 as part of their Rule 3130 annual certification process.

Proposed Additional Firm-Level Exclusions and Conditions

In the Initial Proposal, FINRA proposed excluding some member firms and their offices or locations from participating in the proposed pilot program based on events or activities of a member firm or its associated persons that FINRA believed were more likely to raise investor protection concerns based on the firm's or an associated person's record of specified regulatory or disciplinary events. Specifically, FINRA proposed that a member firm would be ineligible to conduct remote inspections of any of its offices or locations if any time during the period of the proposed pilot program, the member is or becomes designated as a Restricted Firm under Rule 4111; or designated as a Taping Firm under Rule 3170.

In light of these concerns raised by the comment letters in response to the Initial Proposal, FINRA is proposing to expand the list of events that would deem a member firm ineligible to participate in the pilot program to include a member firm that:

- (i) receives a notice from FINRA under Rule 9557 (Procedures for Regulating Activities Under Rules 4110, 4120 and 4130 Regarding a Member Experiencing Financial or Operational Difficulties) under Rule 4110 (Capital Compliance), Rule 4120 (Regulatory Notification and Business Curtailment) or Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties), unless FINRA has otherwise permitted activities in writing pursuant to such rule;
- (ii) is or becomes suspended by FINRA;
- (iii) based on the date in the Central Registration Depository (CRD) had its FINRA membership become effective, within the prior 12 months; or
- (iv) is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c).¹³

¹³ For purposes of proposed Rule 3110.18, the meaning of "found" would align with Rule 4530.03 (Meaning of "Found."), which provides that the term "found" as used in paragraph (a)(1)(A) of Rule 4530, "includes among other formal findings, adverse final actions, including consent decrees in which the respondent has

FINRA believes that a member firm that is experiencing issues complying with its capital requirements or has been suspended by FINRA is more likely to face significant operational challenges that may negatively impact the firm's inspection program. FINRA further believes that a firm that has been a FINRA member for less than 12 months is often still implementing its business plan and may not have sufficient experience to develop a sufficiently robust inspection program. With respect to a firm that is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c), FINRA believes such firms have demonstrated challenges in developing or maintaining robust inspection programs. As such, FINRA believes that these proposed additional ineligibility criteria would appropriately limit the potential population of member firm pilot program participants to those firms that may be better positioned to conduct remote inspections. Moreover, FINRA believes these amendments more appropriately tailor the proposal to maintain investor protection.

To further address commenters' concerns pertaining to the proposed controls of the pilot program, FINRA is proposing to enhance those controls with respect to books and records and surveillance and technology tools. Proposed new paragraph (c)(1)(B) to Rule 3110.18 pertaining to firm level conditions would require:

- (i) (a) the member to have a recordkeeping system to make and keep current, and preserve records required to be made and kept current, and preserved under applicable securities rules and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110; (b) such records are not physically or electronically maintained and preserved at the office or location subject to the remote inspection; and (c) the member has prompt access to such records; and
- (ii) as part of the requirement to develop a reasonable risk-based approach to using remote inspections, and the further requirement to conduct and document a risk assessment for each office or location, the member must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each such office or location. These tools may include but are not limited to: (a) firm-wide tools such as, electronic recordkeeping system; electronic surveillance of e-mail and

neither admitted nor denied the findings, but does not include informal agreements, deficiency letters, examination reports, memoranda of understanding, cautionary actions, admonishments and similar informal resolutions of matters. For example, a Letter of Acceptance, Waiver and Consent or an Order Accepting an Offer of Settlement is considered an adverse final action. The term "found" also includes any formal finding, regardless of whether the finding will be appealed. The term "found" does not include a violation of a self-regulatory organization rule that has been designated as "minor" pursuant to a plan approved by the SEC, if the sanction imposed consists of a fine of \$2,500 or less, and if the sanctioned person does not contest the fine."

correspondence; electronic trade blotters; regular activity-based sampling reviews; and tools for visual inspections; (b) tools specific to that office or location based on the activities of associated persons, products offered, restrictions on the activity of the office or location (including holding out to customers and handling of customer funds or securities); and (c) system tools such as secure network connections and effective cybersecurity protocols.

FINRA believes these proposed new eligibility conditions are appropriate to establish reasonable baseline requirements for remote inspections.

Proposed Additional Location-Level Exclusions and Conditions

In light of the comment letters expressing concern about the discretion provided to firms to make risk assessments of the criteria specified earlier of their offices or locations, FINRA is proposing to expand the list of events or activities that would make specific offices or locations of a member firm ineligible for remote inspections. In the Initial Proposal, FINRA proposed that a specific office or location of a member would not be eligible for a remote inspection in accordance with Rule 3110.18 if any time during the period of the proposed pilot program:

- (i) one or more associated persons at such office or location is or becomes subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or a state regulatory agency;
- (ii) one or more associated persons at such office or location is or becomes statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a mandatory heightened supervisory plan under paragraph (c)(2)(A)(i) of this Supplementary Material or otherwise as a condition to approval or permission for such association;
- (iii) the firm is or becomes subject to Rule 1017(a)(7) as a result of one or more associated persons at such office or location; or
- (iv) one or more associated persons at such location has an event in the prior three years that required a “yes” response to any item in Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4.

With this Partial Amendment No. 1, FINRA is proposing to expand the list of events or activities that would deem a specific office or location of a member ineligible from participating in the pilot program to include an office or location at which:

- (v) one or more associated persons at such office or location is or becomes subject to a disciplinary action taken by the member that is or was reportable under Rule 4530(a)(2); or
- (vi) one or more associated persons at such office or location is a part of the member's trading desk (e.g., engaging in market making activities or having authority to enter proprietary trades on behalf of the member or as agent for other parties); or
- (vii) the office or location handles customers' funds or securities.

FINRA believes the expanded list of exclusions for specific offices or locations of a member further strengthens the terms of the proposed pilot program by identifying additional offices or locations that may particularly benefit from in-person inspections and expressly excluding them, regardless of any individual firm's risk assessment. With respect to item (v), Rule 4530(a)(2) requires a member firm to report when an associated person of the member is the subject of any disciplinary action taken by the member involving suspension, termination, the withholding of compensation or of any other remuneration in excess of \$2,500, the imposition of fines in excess of \$2,500 or is otherwise disciplined in any manner that would have a significant limitation on the individual's activities on a temporary or permanent basis. FINRA believes that where a member firm has determined that its associated person should be subject to any of the disciplinary actions outlined above, it reasonably follows that the activities of such associated person and their office or location should reasonably require in-person oversight by the firm and, as such, requiring an on-site inspection under Rule 3110(c) remains appropriate.

With respect to items (vi) and (vii), FINRA believes that the functions of a member's trading desk and handling customers' funds or securities are significant activities potentially impacting the operations and financial stability of the firm and, as a result, may also significantly impact customers and the markets generally. In guidance pertaining to the branch office definition and the locations excluded from the definition, FINRA described, among other things, the circumstances under which a non-branch location (e.g., a primary residence) may accept customer funds or securities consistent with the condition that "[n]either customer funds nor securities are handled at the location."¹⁴ In accordance with existing guidance, the meaning and interpretation of the term "handled" that currently appears in Rule 3110(f)(2)(A)(ii) would remain consistent in the proposed pilot program.¹⁵

In addition, the processes involved in these activities may at the present time benefit from in-person inspections. Therefore, FINRA believes these offices or locations

¹⁴ See Rule 3110(f)(2)(A)(ii)c.

¹⁵ See Question and Answer 8 in Notice to Members 06-12 (March 2006).

should not be eligible for remote inspections under the proposed pilot program and would be required to be inspected on-site in accordance with current Rule 3110(c).

To further address commenters' concerns regarding the proposed pilot program's controls, FINRA is proposing to add three new eligibility conditions to conduct a remote inspection during the pilot period:

- (i) electronic communications (e.g., e-mail) are made through the member's electronic system;
- (ii) the associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with Rule 3110; and
- (iii) no books or records of the member required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110 are physically or electronically maintained and preserved at such office or location.

Public Interest Determination of Ineligibility

FINRA is also proposing to adopt new paragraph (k) to proposed Rule 3110.18 to allow FINRA to make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the proposed pilot program if the member fails to comply with the requirements of Rule 3110.18. If warranted, FINRA would provide written notice to the member of such determination and such member would no longer be eligible to participate in the proposed pilot program and would be required to conduct on-site inspections of required offices and locations in accordance with Rule 3110(c). FINRA believes this added authority would both align with FINRA's examination and risk monitoring programs for member firms and registered persons and allow FINRA to more effectively assess higher risk.

Additional Economic Analysis

As described above, FINRA is proposing additional requirements that would exclude additional member firms or their offices or locations from participating in the proposed pilot program. The proposed additional requirements reference events or activities of a member firm or its associated persons where increased risk to investors may exist.

Using Central Registration Depository (CRD) data as of early November 2022,¹⁶ FINRA estimates that under the firm level exclusions from the Initial Proposal, 29 firms

¹⁶ FINRA notes that firms may still be relying on the temporary relief provided under Regulatory Notice 20-08 (March 2020) related to updating Form BR

with 350 registered branch offices collectively would not qualify for the proposed pilot program.¹⁷ Under the office or location level exclusions from the Initial Proposal, an additional 868 registered branches belonging to 278 other firms would be excluded.¹⁸ Under the firm level exclusions of both the Initial Proposal and Partial Amendment No. 1, at least approximately 128 firms with 474 registered branches would not qualify for the proposed pilot program.¹⁹ Under the office or location level exclusions of both the Initial Proposal and Partial Amendment No. 1, it remains the case that an additional 868 registered branch offices belonging to 278 other firms would be excluded.²⁰ Thus, a total of approximately 1,342 (= 474+868) registered branch offices would be excluded from the proposed pilot program.²¹ Based on these figures, FINRA anticipates that at most approximately 2,884 small firms, 183 mid-size firms and 166 large firms could

(Uniform Branch Office Registration Form) and Form U4 (Uniform Application for Securities Industry Registration or Transfer).

¹⁷ See proposed Rule 3110.18(b)(2)(A) in the Initial Proposal, renumbered as proposed Rule 3110.18(c)(1)(A) in Partial Amendment No. 1.

¹⁸ See proposed Rule 3110.18(b)(2)(B) in the Initial Proposal renumbered as proposed Rule 3110.18(c)(2)(A) in Partial Amendment No. 1. FINRA notes that the impacts of some of the office or location exclusions of the Initial Proposal cannot be readily quantified for purposes of this calculation. For 43 of the 278 firms impacted by branch-level exclusions, all branches are excluded thereby fully excluding the firm from participation in the proposed pilot program. The other 235 firms are only partially excluded from the pilot.

¹⁹ See Rule 3110.18(c)(1) as proposed with this Partial Amendment No. 1. FINRA notes that the impacts of some of the firm-level exclusions and conditions as modified by this Partial Amendment No. 1 cannot be readily quantified for purposes of this calculation.

²⁰ See Rule 3110.18(c)(2) as proposed with this Partial Amendment No. 1. FINRA notes that the impacts of the office/location level exclusions and conditions as modified by this Partial Amendment No. 1 cannot be readily quantified for purposes of this calculation.

²¹ There are approximately 152,000 registered branch offices. In addition, approximately 1,800 firms have a single registered branch office and ten or fewer registered representatives or no registered branch offices. FINRA anticipates that such firms would be less likely to elect to participate in the proposed pilot program. The reason is that it is less likely that these firms would have enough staff working from home such that the benefit of conducting remote inspections relative to the cost of sending data to FINRA and meeting the other proposed pilot program requirements would make participation in the proposed pilot program more practical than conducting physical inspections or eliminating remote work.

potentially participate in the proposed pilot program and that most large firms would have some branch offices excluded.

Attachment A: Alphabetical List of Commenters to File No. SR-FINRA-2022-021

1. Helen Barnhill, Teachers Insurance and Annuity Association of America (“TIAA”) (September 6, 2022)
2. Jacqueline A. Beauprez & Brian Zellner, D.A. Davidson & Co. (“Davidson”) (September 6, 2022)
3. David T. Bellaire, Financial Services Institute (“FSI I”) (September 6, 2022)
4. Peggy E. Chait & Howard Spindel, Integrated Solutions (“Integrated Solutions”) (September 5, 2022)
5. Mackenzie Connick & Christine Lazaro, St. John’s University School of Law (“SJU”) (September 6, 2022)
6. Michael S. Edmiston, Public Investors Advocate Bar Association (“PIABA I”) (September 6, 2022)
7. Erica Green, Vanguard Marketing Corporation (“Vanguard”) (September 6, 2022)
8. Christopher A. Iacovella, American Securities Association (“ASA”) (September 6, 2022)
9. William A. Jacobson & Dustin Hartuv, Cornell Securities Law Clinic (“Cornell”) (September 6, 2022)
10. Clifford Kirsch & Eric Arnold, Eversheds Sutherland (US) LLP for the Committee of Annuity Insurers (“CAI I”) (September 6, 2022)
11. Melanie Senter Lubin, North American Securities Administrators Association, Inc. (“NASAA I”) (August 23, 2022)
12. Gavin Lucca, Commonwealth Financial Network (“CFN”) (September 6, 2022)
13. Jim McHale & Robert Mulligan, Wells Fargo & Company (“WFC”) (September 6, 2022)
14. Gail Merken, Janet Dyer & John McGinty, Fidelity Investments (“Fidelity”) (September 6, 2022)
15. Seth Miller, Cambridge Investment Research, Inc. (“Cambridge”) (September 6, 2022)
16. Dee O’Neill, Raymond James & Associates, Inc. (“Raymond James”) (September 6, 2022)
17. Mark Quinn, Cetera Financial Group, Inc. (“Cetera”) (September 6, 2022)
18. Stefanie Reel, Liberty Capital Investment Corp. (“Liberty Capital”) (September 1, 2022)

19. Mark Seffinger, LPL Financial, (“LPL”) (September 6, 2022)
20. Mark Seffinger, LPL, (October 25, 2022)
21. Karol Sierra-Yanez, MML Investors Services, LLC (“MMLIS”) (September 6, 2022)
22. Jennifer L. Szaro, (“Szaro”) (September 6, 2022)
23. Jennifer L. Szaro, XML Securities, LLC (“Group of 16”) (October 25, 2022)
24. Justine Tobin, Tobin & Company Securities LLC (“Tobin”) (September 6, 2022)
25. Kevin Zambrowicz & Bernard V. Canepa, Securities Industry and Financial Markets Association (“SIFMA”) (September 6, 2022)
26. Kevin Zambrowicz & Bernard V. Canepa, SIFMA (September 30, 2022)
27. Kevin Zambrowicz & Bernard V. Canepa, SIFMA (October 19, 2022)
28. Brad Ziemba, Finalis Securities LLC (“Finalis”) (September 5, 2022)

Exhibit 4

Exhibit 4 shows the changes proposed in this Partial Amendment No. 1, with the proposed changes in the original filing shown as if adopted. Proposed new language in this Partial Amendment No. 1 is underlined; proposed deletions in this Partial Amendment No. 1 are in brackets.

* * * * *

3100. SUPERVISORY RESPONSIBILITIES

3110. Supervision

(a) through (f) No Change.

• • • Supplementary Material: -----

.01 through **.17** No Change.

.18 Remote Inspections Pilot Program

(a) No Change.

(b) [Use of Remote Inspections]Risk Assessments

(1) Subject to paragraphs [(b)(2)] (c) and (d) of this Supplementary Material, each member obligated to conduct an inspection of an office or location during the pilot period pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110 may, subject to the requirements of this Rule 3110.18, elect to conduct the applicable inspection remotely, without necessarily an on-site visit for an office or location, when the member reasonably determines that the purposes of this Supplementary Material can be accomplished by conducting such required inspection remotely. Prior to electing a remote inspection for an office or location, rather than an on-site inspection, the firm must develop a reasonable risk-based approach to using remote inspections, and conduct and document a risk assessment for that office or location. The assessment must document the factors

considered, including the factors set forth in Rule 3110.12 and must take into account any higher risk activities that take place or higher risk associated persons that are assigned to that office or location. A member that is not eligible to conduct remote inspections in accordance with paragraph [(b)(2)](c) of this Supplementary Material must conduct an on-site inspection of that office or location on the required cycle. Notwithstanding Rule 3110.18, a member shall remain subject to the other requirements of Rule 3110(c).

(2) In conducting the risk assessment of each office or location in accordance with Rule 3110.18(b)(1), a member shall consider, among other things, the following in making their risk-based evaluation of each office or location: (A) the volume and nature of customer complaints; (B) the volume and nature of outside business activities, particularly investment-related; (C) the volume and complexity of products offered; (D) the nature of the customer base, including vulnerable adult investors; (E) whether associated persons are subject to heightened supervision; (F) failures by associated persons to comply with the member's written supervisory procedures; and (G) any recordkeeping violations. In addition, consistent with Rule 3110.12, members should conduct on-site inspections or make more frequent use of unannounced, on-site inspections for high-risk locations or where there are "red flags."

(c) Eligibility Exclusions and Conditions

(1) Firm Level

[2](A) A member shall not be eligible to conduct remote inspections of any of its offices or locations in accordance with this

Supplementary Material if any time during the period of this Remote Inspections Pilot Program, the member[is or becomes]:

(i) is or becomes designated as Restricted Firm under Rule 4111; [or]

(ii) is or becomes designated as a Taping Firm under Rule 3170[.];

(iii) receives a notice from FINRA under Rule 9557 under Rule 4110 (Capital Compliance), Rule 4120 (Regulatory Notification and Business Curtailment) or Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties), unless FINRA has otherwise permitted activities in writing pursuant to such rule;

(iv) is or becomes suspended by FINRA;

(v) based on the date in the Central Registration Depository (CRD), had its FINRA membership become effective within the prior 12 months; or

(vi) is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c) (Internal Inspections).

(B) In addition to the requirements of this Supplementary Material, during the period that a member is participating in this Remote Inspections Pilot Program the member must satisfy the following

conditions to be eligible to conduct remote inspections of any of its offices or locations in accordance with this Supplementary Material:

(i)(a) the member must have a recordkeeping system to make and keep current, and preserve records required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110; (b) such records are not physically or electronically maintained and preserved at the office or location subject to the remote inspection; and (c) the member has prompt access to such records; and

(ii) as part of the requirement to develop a reasonable risk-based approach to using remote inspections, and the further requirement to conduct and document a risk assessment for each office or location, the member must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each such office or location. These tools may include but are not limited to: (a) firm-wide tools such as, electronic recordkeeping system; electronic surveillance of e-mail and correspondence; electronic trade blotters; regular activity-based sampling reviews; and tools for visual inspections; (b) tools specific to that office or location based on the activities of associated persons, products offered, restrictions on the activity of the office or location (including holding out to customers and

handling of customer funds or securities); and (c) system tools such as secure network connections and effective cybersecurity protocols.

[(B)](2) Location Level

(A) A specific office or location of a member shall not be eligible for a remote inspection in accordance with this Supplementary Material if any time during the period of this Remote Inspections Pilot Program[, an associated person at such office or location is or becomes]:

(i) one or more associated persons at such office or location is or becomes subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or a state regulatory agency;

(ii) one or more associated persons at such office or location is or becomes statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a mandatory heightened supervisory plan under paragraph [(b)(2)(B)(i)](c)(2)(A)(i) of this Supplementary Material or otherwise as a condition to approval or permission for such association;

(iii) the firm is or becomes subject to Rule 1017(a)(7) as a result of one or more associated persons at such office or location;
or

(iv) one or more associated persons at such office or location has an event in the prior three years that required a "yes" response to any item in Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4[.];

(v) one or more associated persons at such office or location is or becomes subject to a disciplinary action taken by the member that is or was reportable under Rule 4530(a)(2);

(vi) one or more associated persons at such office or location is a part of the member's trading desk (e.g., engaging in market making activities or having authority to enter proprietary trades on behalf of the member or as agent for other parties; or

(vii) the office or location handles customers' funds or securities.

(B) In addition to the requirements of this Supplementary Material, during the period a member is participating in this Remote Inspections Pilot Program a specific office or location of the member must satisfy the following conditions to be eligible for a remote inspection in accordance with this Supplementary Material:

(i) electronic communications (e.g., e-mail) are made through the member's electronic system;

(ii) the associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with Rule 3110; and

(iii) no books or records of the member required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110 are physically or electronically maintained and preserved at such office or location.

[(c)](d) Written Supervisory Procedures for Remote Inspections. Consistent with a member's obligation under Rule 3110(b)[(1)], a member that elects to participate in the Remote Inspections Pilot Program must adopt written supervisory procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Reasonably designed procedures for conducting remote inspections of offices or locations should include, among other things: (1) a description of the methodology, including technology, that may be used to conduct remote inspections; (2) the factors considered in the risk assessment made for each applicable office or location pursuant to paragraph (b) of this Supplementary Material; and (3) the use of other risk-based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.

[(d)](e) Effective Supervisory System. The requirement to conduct inspections of offices and locations is one part of the member's overall obligation to have an effective

supervisory system and therefore the member must continue with its ongoing review of the activities and functions occurring at all offices and locations, whether or not the member conducts inspections remotely. A member's use of a remote inspection of an office or location will be subject to the same standards for review as set forth under Rule 3110.12. Where a member's remote inspection of an office or location identifies any indicators of irregularities or misconduct (i.e., "red flags"), the member may need to impose additional supervisory procedures for that office or location or may need to provide for more frequent monitoring of that office or location, including potentially a subsequent on-site visit on an announced or unannounced basis.

[(e)](f) Documentation Requirement. A member must maintain and preserve a centralized record for each of the Pilot Years specified in this Remote Inspections Pilot Program that separately identifies: (1) all offices or locations that were inspected remotely; and (2) any offices or locations for which the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in Rule 3110.18[(d)](e). A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection, including whether an on-site inspection was conducted at such office.

[(f)](g) Data and Information Collection Requirement

(1) Data and Information. A member that elects to participate in the Remote Inspections Pilot Program shall collect the following data and information and provide such data and information to FINRA, on a periodic basis (not to exceed quarterly), and in the manner and format determined by FINRA. For items

(A) through (F) below, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110; and the term "findings" means items that led to any remedial action or were listed on an inspection report by the member:

(A) number of locations with an inspection completed during each calendar quarter;

(B) number of locations in item (A) that were inspected remotely;

(C) number of locations in item (A) that were inspected on-site;

(D) number of locations in item (C) that were inspected on-site because of a finding;

(E) number of locations in item (B) where findings were identified, the number of those findings and a list of the most significant findings;

(F) number of locations in item (C) where findings were identified, the number of those findings and a list of the most significant findings; and

(G) requirements of the Written Supervisory Procedures for Remote Inspections in each of the four areas below. This information should be provided with the first delivery of data made pursuant to this Rule 3110.18[(f)](g), and thereafter with the first delivery of such data made after any amendments to the Written Supervisory Procedures for Remote Inspections:

- (i) procedures for escalating significant findings;
- (ii) procedures for new hires;
- (iii) procedures for supervising brokers with a significant history of misconduct; and
- (iv) procedures related to outside business activities (OBAs) and doing business as (DBA) designations.

(2) Additional Data and Information for Pilot Year 1. In addition to the information set forth in paragraph [(f)](g)(1) of this Supplementary Material, if Pilot Year 1 covers a period that is less than a full calendar year, a member that elects to participate the Remote Inspections Pilot Program shall collect the following data and information and provide such data and information to FINRA no later than December 31 of such first Pilot Year in the manner and format determined by FINRA. For items (A) through (C) below, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110:

(A) the number of locations with an inspection completed during the full calendar year of the first Pilot Year;

(B) the number of locations in item (A) that were inspected remotely during the full calendar year of the first Pilot Year; and

(C) the number of locations in item (A) that were inspected on-site during the full calendar year of the first Pilot Year.

(3) Written Policies and Procedures. A member shall establish, maintain and enforce written policies and procedures that are reasonably designed to comply with the data and information collection, and transmission requirements of paragraph [(f)](g) of this Supplementary Material.

[(g)](h) Remote Inspections Pilot Program Participation. A member that elects to participate in the Remote Inspections Pilot Program for any Pilot Year shall, at least five calendar days before the beginning of such Pilot Year, provide FINRA an "opt-in notice" in the manner and format determined by FINRA. By providing such opt-in notice to FINRA, the member agrees to participate in the Remote Inspections Pilot Program for the duration of such Pilot Year and to comply with the requirements of Rule 3110.18. A member that provides an opt-in notice for a Pilot Year shall be automatically deemed to have elected and agreed to participate in the Remote Inspections Pilot Program for subsequent Pilot Years until the Remote Inspections Pilot Program expires. A member that elects to withdraw from subsequent Pilot Years (i.e., Pilot Year 2, Pilot Year 3, and Pilot Year 4, if applicable) shall, at least five calendar days before the end of the then current Pilot Year, provide FINRA with a "opt-out notice" in the manner and format determined by FINRA. FINRA may, in exceptional cases and where good cause is shown, waive the applicable timeframes for the required opt-in or opt-out notices.

[(h)](i) Definitions. For purposes of this Supplementary Material, the term "Pilot Year" shall mean the following:

(1) Pilot Year 1 is the period beginning on [insert effective date] and ending on December 31 of the same year;

(2) Pilot Year 2 means the calendar year period following Pilot Year 1, beginning on January 1 and ending on December 31;

(3) Pilot Year 3 means the calendar year period following Pilot Year 2, beginning on January 1 and ending on December 31; and

(4) If applicable, where Pilot Year 1 covers a period that is less than a full calendar year, then Pilot Year 4 means the period following Pilot Year 3, beginning on January 1 and ending on [insert date that is three years after effective date].

[(i)](i) Failure to Satisfy Conditions. A member that fails to satisfy the conditions of Rule 3110.18, including the requirement to timely collect and submit the data and information to FINRA as set forth in paragraph [(f)](g) of this Supplementary Material, shall be ineligible to participate in the Remote Inspections Pilot Program and must conduct on-site inspections of each office and location on the required cycle in accordance with Rule 3110(c).

(k) Determination of Ineligibility. FINRA may make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the Pilot Program if the member fails to comply with the requirements of Rule 3110.18. In such instances, FINRA will provide written notice to the member of such determination and the member would no longer be eligible to participate in the Pilot Program and must conduct on-site inspections of required offices and locations in accordance with Rule 3110(c).

[(j)](l) Sunset of Rule 3110.17. If Rule 3110.17 has not already expired by its own terms, Rule 3110.17 will automatically sunset on [insert effective date].

.19 Reserved.

* * * * *

EXHIBIT 5

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

3100. SUPERVISORY RESPONSIBILITIES

3110. Supervision

(a) through (f) No Change.

• • • **Supplementary Material:** -----

.01 through .17 No Change.

.18 Remote Inspections Pilot Program

(a) Scope of Pilot. This Supplementary Material establishes a pilot program ("Remote Inspections Pilot Program") with respect to the required inspection of offices of supervisory jurisdiction, branch offices and non-branch locations pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110. The Remote Inspections Pilot Program shall cover required inspections of such offices or locations for a period of three years starting on [insert effective date] ("pilot period"), and such pilot period shall expire on [insert date that is three years after effective date]. If the pilot period is not extended or Rule 3110.18, as may be amended, is not approved as permanent by the Commission, this Supplementary Material will automatically sunset on [insert date that is three years after effective date]. Members will not be able to avail themselves of the Remote Inspections Pilot Program after such date.

(b) Risk Assessments

(1) Subject to paragraphs (c) and (d) of this Supplementary Material, each member obligated to conduct an inspection of an office or location during the

pilot period pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110 may, subject to the requirements of this Rule 3110.18, elect to conduct the applicable inspection remotely, without necessarily an on-site visit for an office or location, when the member reasonably determines that the purposes of this Supplementary Material can be accomplished by conducting such required inspection remotely. Prior to electing a remote inspection for an office or location, rather than an on-site inspection, the firm must develop a reasonable risk-based approach to using remote inspections, and conduct and document a risk assessment for that office or location. The assessment must document the factors considered, including the factors set forth in Rule 3110.12 and must take into account any higher risk activities that take place or higher risk associated persons that are assigned to that office or location. A member that is not eligible to conduct remote inspections in accordance with paragraph (c) of this Supplementary Material must conduct an on-site inspection of that office or location on the required cycle. Notwithstanding Rule 3110.18, a member shall remain subject to the other requirements of Rule 3110(c).

(2) In conducting the risk assessment of each office or location in accordance with Rule 3110.18(b)(1), a member shall consider, among other things, the following in making their risk-based evaluation of each office or location: (A) the volume and nature of customer complaints; (B) the volume and nature of outside business activities, particularly investment-related; (C) the volume and complexity of products offered; (D) the nature of the customer base, including vulnerable adult investors; (E) whether associated persons are subject to

heightened supervision; (F) failures by associated persons to comply with the member's written supervisory procedures; and (G) any recordkeeping violations. In addition, consistent with Rule 3110.12, members should conduct on-site inspections or make more frequent use of unannounced, on-site inspections for high-risk locations or where there are "red flags."

(c) Eligibility Exclusions and Conditions

(1) Firm Level

(A) A member shall not be eligible to conduct remote inspections of any of its offices or locations in accordance with this Supplementary Material if any time during the period of this Remote Inspections Pilot Program, the member:

(i) is or becomes designated as Restricted Firm under Rule 4111;

(ii) is or becomes designated as a Taping Firm under Rule 3170;

(iii) receives a notice from FINRA under Rule 9557 under Rule 4110 (Capital Compliance), Rule 4120 (Regulatory Notification and Business Curtailment) or Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties), unless FINRA has otherwise permitted activities in writing pursuant to such rule;

(iv) is or becomes suspended by FINRA;

(v) based on the date in the Central Registration Depository (CRD), had its FINRA membership become effective within the prior 12 months; or

(vi) is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c) (Internal Inspections).

(B) In addition to the requirements of this Supplementary Material, during the period that a member is participating in this Remote Inspections Pilot Program the member must satisfy the following conditions to be eligible to conduct remote inspections of any of its offices or locations in accordance with this Supplementary Material:

(i)(a) the member must have a recordkeeping system to make and keep current, and preserve records required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules, and the member's own written supervisory procedures under to Rule 3110; (b) such records are not physically or electronically maintained and preserved at the office or location subject to the remote inspection; and (c) the member has prompt access to such records; and

(ii) as part of the requirement to develop a reasonable risk-based approach to using remote inspections, and the further requirement to conduct and document a risk assessment for each office or location, the member must determine that its surveillance

and technology tools are appropriate to supervise the types of risks presented by each such office or location. These tools may include but are not limited to: (a) firm-wide tools such as, electronic recordkeeping system; electronic surveillance of e-mail and correspondence; electronic trade blotters; regular activity-based sampling reviews; and tools for visual inspections; (b) tools specific to that office or location based on the activities of associated persons, products offered, restrictions on the activity of the office or location (including holding out to customers and handling of customer funds or securities); and (c) system tools such as secure network connections and effective cybersecurity protocols.

(2) Location Level

(A) A specific office or location of a member shall not be eligible for a remote inspection in accordance with this Supplementary Material if any time during the period of this Remote Inspections Pilot Program:

(i) one or more associated persons at such office or location is or becomes subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or a state regulatory agency;

(ii) one or more associated persons at such office or location is or becomes statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted

pursuant to FINRA rules and the federal securities laws) to
associate with a member and is not subject to a mandatory
heightened supervisory plan under paragraph (c)(2)(A)(i) of this
Supplementary Material or otherwise as a condition to approval or
permission for such association;

(iii) the firm is or becomes subject to Rule 1017(a)(7) as a
result of one or more associated persons at such office or location;
or

(iv) one or more associated persons at such office or
location has an event in the prior three years that required a "yes"
response to any item in Questions 14A(1)(a) and 2(a), 14B(1)(a)
and 2(a), 14C, 14D and 14E on Form U4;

(v) one or more associated persons at such office or
location is or becomes subject to a disciplinary action taken by the
member that is or was reportable under Rule 4530(a)(2);

(vi) one or more associated persons at such office or
location is a part of the member's trading desk (e.g., engaging in
market making activities or having authority to enter proprietary
trades on behalf of the member or as agent for other parties); or

(vii) the office or location handles customers' funds or
securities.

(B) In addition to the requirements of this Supplementary
Material, during the period a member is participating in this Remote

Inspections Pilot Program a specific office or location of the member must satisfy the following conditions to be eligible for a remote inspection in accordance with this Supplementary Material:

- (i) electronic communications (e.g., e-mail) are made through the member's electronic system;
- (ii) the associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with Rule 3110; and
- (iii) no books or records of the member required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules and the member's own written supervisory procedures under Rule 3110 are physically or electronically maintained and preserved at such office or location.

(d) Written Supervisory Procedures for Remote Inspections. Consistent with a member's obligation under Rule 3110(b), a member that elects to participate in the Remote Inspections Pilot Program must adopt written supervisory procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Reasonably designed procedures for conducting remote inspections of offices or locations should include, among other things: (1) a description of the methodology, including technology, that may be used to conduct remote inspections; (2) the factors considered in the risk assessment made for each applicable office or location pursuant to paragraph (b) of this Supplementary Material; and (3) the use of other risk-

based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.

(e) Effective Supervisory System. The requirement to conduct inspections of offices and locations is one part of the member's overall obligation to have an effective supervisory system and therefore the member must continue with its ongoing review of the activities and functions occurring at all offices and locations, whether or not the member conducts inspections remotely. A member's use of a remote inspection of an office or location will be subject to the same standards for review as set forth under Rule 3110.12. Where a member's remote inspection of an office or location identifies any indicators of irregularities or misconduct (i.e., "red flags"), the member may need to impose additional supervisory procedures for that office or location or may need to provide for more frequent monitoring of that office or location, including potentially a subsequent on-site visit on an announced or unannounced basis.

(f) Documentation Requirement. A member must maintain and preserve a centralized record for each of the Pilot Years specified in this Remote Inspections Pilot Program that separately identifies: (1) all offices or locations that were inspected remotely; and (2) any offices or locations for which the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in Rule 3110.18(e). A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection, including whether an on-site inspection was conducted at such office.

(g) Data and Information Collection Requirement

(1) Data and Information. A member that elects to participate in the Remote Inspections Pilot Program shall collect the following data and information and provide such data and information to FINRA, on a periodic basis (not to exceed quarterly), and in the manner and format determined by FINRA. For items (A) through (F) below, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110; and the term "findings" means items that led to any remedial action or were listed on an inspection report by the member:

(A) number of locations with an inspection completed during each calendar quarter;

(B) number of locations in item (A) that were inspected remotely;

(C) number of locations in item (A) that were inspected on-site;

(D) number of locations in item (C) that were inspected on-site because of a finding;

(E) number of locations in item (B) where findings were identified, the number of those findings and a list of the most significant findings;

(F) number of locations in item (C) where findings were identified, the number of those findings and a list of the most significant findings; and

(G) requirements of the Written Supervisory Procedures for Remote Inspections in each of the four areas below. This information should be provided with the first delivery of data made pursuant to this Rule 3110.18(g), and thereafter with the first delivery of such data made after any amendments to the Written Supervisory Procedures for Remote Inspections:

- (i) procedures for escalating significant findings;
- (ii) procedures for new hires;
- (iii) procedures for supervising brokers with a significant history of misconduct; and
- (iv) procedures related to outside business activities (OBAs) and doing business as (DBA) designations.

(2) Additional Data and Information for Pilot Year 1. In addition to the information set forth in paragraph (g)(1) of this Supplementary Material, if Pilot Year 1 covers a period that is less than a full calendar year, a member that elects to participate the Remote Inspections Pilot Program shall collect the following data and information and provide such data and information to FINRA no later than December 31 of such first Pilot Year in the manner and format determined by FINRA. For items (A) through (C) below, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110:

(A) the number of locations with an inspection completed during the full calendar year of the first Pilot Year;

(B) the number of locations in item (A) that were inspected remotely during the full calendar year of the first Pilot Year; and

(C) the number of locations in item (A) that were inspected on-site during the full calendar year of the first Pilot Year.

(3) Written Policies and Procedures. A member shall establish, maintain and enforce written policies and procedures that are reasonably designed to comply with the data and information collection, and transmission requirements of paragraph (g) of this Supplementary Material.

(h) Remote Inspections Pilot Program Participation. A member that elects to participate in the Remote Inspections Pilot Program for any Pilot Year shall, at least five calendar days before the beginning of such Pilot Year, provide FINRA an "opt-in notice" in the manner and format determined by FINRA. By providing such opt-in notice to FINRA, the member agrees to participate in the Remote Inspections Pilot Program for the duration of such Pilot Year and to comply with the requirements of Rule 3110.18. A member that provides an opt-in notice for a Pilot Year shall be automatically deemed to have elected and agreed to participate in the Remote Inspections Pilot Program for subsequent Pilot Years until the Remote Inspections Pilot Program expires. A member that elects to withdraw from subsequent Pilot Years (i.e., Pilot Year 2, Pilot Year 3, and Pilot Year 4, if applicable) shall, at least five calendar days before the end of the then current Pilot Year, provide FINRA with a "opt-out notice" in the manner and format

determined by FINRA. FINRA may, in exceptional cases and where good cause is shown, waive the applicable timeframes for the required opt-in or opt-out notices.

(i) Definitions. For purposes of this Supplementary Material, the term "Pilot Year" shall mean the following:

(1) Pilot Year 1 is the period beginning on [insert effective date] and ending on December 31 of the same year;

(2) Pilot Year 2 means the calendar year period following Pilot Year 1, beginning on January 1 and ending on December 31;

(3) Pilot Year 3 means the calendar year period following Pilot Year 2, beginning on January 1 and ending on December 31; and

(4) If applicable, where Pilot Year 1 covers a period that is less than a full calendar year, then Pilot Year 4 means the period following Pilot Year 3, beginning on January 1 and ending on [insert date that is three years after effective date].

(j) Failure to Satisfy Conditions. A member that fails to satisfy the conditions of Rule 3110.18, including the requirement to timely collect and submit the data and information to FINRA as set forth in paragraph (g) of this Supplementary Material, shall be ineligible to participate in the Remote Inspections Pilot Program and must conduct on-site inspections of each office and location on the required cycle in accordance with Rule 3110(c).

(k) Determination of Ineligibility. FINRA may make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the Pilot Program if the member fails to comply with the requirements of

Rule 3110.18. In such instances, FINRA will provide written notice to the member of such determination and the member would no longer be eligible to participate in the Pilot Program and must conduct on-site inspections of required offices and locations in accordance with Rule 3110(c).

(l) **Sunset of Rule 3110.17.** If Rule 3110.17 has not already expired by its own terms, Rule 3110.17 will automatically sunset on [insert effective date].

.19 Reserved.

* * * * *



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December 15, 2022

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

**Re: File No. SR-FINRA-2022-021 – Proposed Rule Change to Adopt
Supplementary Material .18 (Remote Inspections Pilot Program) under
FINRA Rule 3110 (Supervision)**

Dear Ms. Countryman:

The Financial Industry Regulatory Authority, Inc. (“FINRA”) submits this letter in response to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) regarding the above-referenced rule filing to amend FINRA Rule 3110 (Supervision) to add new Supplementary Material .18 (Remote Inspections Pilot Program) (the “Proposal”). Proposed Rule 3110.18 would establish a voluntary, three-year remote inspection pilot program to allow member firms to fulfill their obligation under Rule 3110(c) (Internal Inspections) by conducting inspections of some or all branch offices and locations remotely without an on-site visit to such office or location, subject to specified terms.

The Commission published the Proposal for public comment in the Federal Register on August 15, 2022, and the comment period closed on September 6, 2022.¹ For this first comment period, the Commission received 28 comment letters in response to the Proposal,

¹ See Securities Exchange Act Release No. 95452 (August 9, 2022), 87 FR 50144 (August 15, 2022) (Notice of Filing of File No. SR-FINRA-2022-021).

of which 24 comment letters express support for the Proposal’s overall intent.² On September 23, 2022, FINRA consented to an extension of the time period for SEC action on the proposed rule change to November 11, 2022.³ On November 9, 2022, FINRA filed with the SEC a letter stating it was still considering the comments to the Proposal, and anticipated submitting a response to comments and amendments to the Proposal in the near future.⁴ On November 10, 2022, the Commission instituted proceedings to determine whether to approve or disapprove the Proposal.⁵ The second comment period closed on December 7, 2022.⁶ In response to this second comment period, the SEC received four comment letters.⁷ CAI and FSI, which previously submitted supportive comment letters addressing the Proposal,⁸ reaffirm their overall support.⁹ NASAA and PIABA, each of

² See Attachment A for the list of commenters. The 28 comment letters consist of 25 unique comment letters, one supplemental comment letter from LPL and two supplemental comment letters from SIFMA.

³ See Letter from Sarah Kwak, Associate General Counsel, FINRA, to Daniel Fisher, Division of Trading and Markets, SEC, dated September 23, 2022.

⁴ See Letter from Sarah Kwak, Associate General Counsel, FINRA, to Vanessa Countryman, Secretary, SEC, dated November 9, 2022.

⁵ See Securities Exchange Act Release No. 96297 (November 10, 2022), 87 FR 68774 (November 16, 2022) (Order Instituting Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2022-021).

⁶ See note 5, supra.

⁷ See Letter from Eric Arnold & Clifford Kirsch, Eversheds Sutherland (US) LLP for the Committee of Annuity Insurers, to Secretary, SEC, dated December 7, 2022 (“CAI II”); Letter from David T. Bellaire, Esq., Executive Vice President & General Counsel, Financial Services Institute, to Secretary, SEC, dated December 7, 2022 (“FSI II”); Letter from Andrew Hartnett, President, North American Securities Administrators Association, Inc., to Sherry R. Haywood, Assistant Secretary, SEC, dated December 7, 2022 (“NASAA II”); and Letter from Hugh D. Berkson, President, Public Investors Advocate Bar Association, to Vanessa Countryman, SEC, dated December 7, 2022 (“PIABA II”).

⁸ See note 2, supra.

⁹ See CAI II, FSI II.

which also previously submitted a comment letter in opposition to the Proposal,¹⁰ reaffirm their opposition.¹¹

This letter responds to the main issues raised by commenters. Many commenters view the Proposal as a step towards modernizing FINRA rules.¹² For example, the Group of 16, composed mostly of small member firms, states that the Proposal is “aimed toward modernizing the FINRA Rule book built on investor protection objectives, not reducing them.” Fidelity expresses appreciation for FINRA’s “willingness to evolve its longstanding in-person inspection requirements based on lessons learned during the COVID-19 pandemic, evolving technology and current and future workforce arrangements.” Similarly, Davidson states that the Proposal “allows for modernization of Rule 3110(c) and builds on the successful execution of remote inspections since the beginning of the COVID-19 pandemic.” Moreover, several commenters further note the positive impact the Proposal will have on workplace flexibility and hiring efforts that enhance talent recruitment and retention in the financial industry, particularly with respect to diversity and inclusion initiatives.¹³

Four commenters—Cornell, NASAA, PIABA and SJU—express concerns with the Proposal.¹⁴ While SJU conveys general support for innovating firm supervision, it expresses concerns pertaining to the scope of the Proposal. Cornell, NASAA and PIABA are critical of the Proposal and oppose it, stating it will adversely impact investor protection. In general, these commenters express concerns relating to: the adequacy and scope of the proposed pilot program’s controls—the exclusions and conditions—to address higher-risk conduct; the identification of technologies firms would use to conduct their inspections remotely; the fundamental change to the approach of supervision; monitoring for pilot program compliance; and the lack of data to fully support the effectiveness of remote inspections.

FINRA is contemporaneously submitting Partial Amendment No. 1, which proposes changes to the Proposal informed by the comments. Partial Amendment No. 1 proposes to amend proposed Supplementary Material .18 to Rule 3110 to:

¹⁰ See note 2, supra.

¹¹ See NASAA II, PIABA II.

¹² See ASA, Cambridge, Cetera, Davidson, Fidelity, Finalis, FSI I, Group of 16, LPL I, MMLIS, Raymond James, SIFMA I, Szaro, TIAA, Tobin, Vanguard, WFC.

¹³ See Cambridge, MMLIS, Raymond James, SIFMA I, Vanguard, WFC.

¹⁴ See also NASAA II, PIABA II.

- (1) add specific risk criteria that a member must consider in making its risk-based evaluation of an office or location;
- (2) expand the list of exclusions that would make a member ineligible to participate in the proposed pilot program;
- (3) expand the list of exclusions that would make a specific office or location of a member ineligible for a remote inspection;
- (4) add express conditions that a member must satisfy to be eligible to conduct remote inspections of any of its offices or locations;
- (5) add express conditions that a specific office or location of a member must satisfy to be eligible for a remote inspection; and
- (6) add a new provision to allow FINRA to make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the proposed pilot program if a member fails to comply with the requirements of Rule 3110.18.

The following are FINRA's responses to the material issues raised by commenters.¹⁵

Categories of Eligibility Exclusions and Conditions

The Proposal would exclude some member firms and their offices or locations from participating in the proposed pilot program based on events of a member firm or its associated persons that FINRA believes are more likely to raise investor protection concerns, as reflected by the firm's or an associated person's record of specified regulatory or disciplinary events. The Proposal would also require a firm to conduct a risk assessment for each office or location that is selected to be inspected remotely, which assessment must document the factors the firm considered; require a firm to establish and maintain written supervisory procedures to include descriptions of the methodology, including technology,

¹⁵ FINRA notes that the comment letters from ASA, Group of 16, LPL II, NASAA I and SIFMA III for this Proposal are the same as the comment letters they each submitted in response to FINRA's proposed rule change relating to the adoption of proposed Rule 3110.19 (Residential Supervisory Location). See Securities Exchange Act Release No. 95379 (July 27, 2022), 87 FR 47248 (August 2, 2022) (Notice of Filing of File No. SR-FINRA-2022-019) ("RSL Proposal"), <https://www.sec.gov/comments/sr-finra-2022-019/srfinra2022019.htm>.

that may be used to conduct the remote inspections; and impose a data and information collection requirement.¹⁶

NASAA contends that the proposed controls in the Proposal, in general, are insufficient, pointing to the level of subjectivity a firm is permitted to apply in determining which offices or locations to inspect remotely and in conducting the accompanying risk assessment. SJU expresses concerns with the scope of the Proposal; in particular, the controls governing both the proposed firm-level and location-level exclusions and conditions. SJU appreciates the Proposal's restriction on high-risk firms but does not think the Proposal would adequately capture high-risk conduct. While SJU acknowledges that the Proposal would exclude certain brokers who have engaged in certain types of misconduct or who have criminal convictions, it believes the Proposal should go further and exclude locations at which associated persons work who have a history of customer complaints, unless they are subject to special supervision. SJU also believes that the Proposal should exclude from the proposed pilot program locations where there are brokers who have complaints, internal investigations, or terminations concerning allegations related to outside business activities, private securities transactions, forgery, theft, misappropriation or conversion of funds or securities.

In response to these comments, and as described in more detail below, Partial Amendment No. 1 would impose additional exclusions and conditions at the member firm level and the office or location level.

Proposed Additional Risk Assessment Criteria

Under the Proposal, a member firm, prior to electing a remote inspection for an office or location rather than an on-site inspection, must develop a reasonable risk-based approach to using remote inspections, and conduct and document a risk assessment for that office or location. The assessment must document the factors considered, including the factors set forth in Rule 3110.12 (Standards for Reasonable Review) and take into account any higher risk activities that take place or higher risk associated persons that are assigned to that location.

In light of concerns raised by commenters that a firm might not appropriately consider certain higher risk criteria in conducting its risk assessment, FINRA is proposing to add new paragraph (b)(2) to proposed Rule 3110.18 that would provide a non-exhaustive list of factors that a firm must consider and document. Specifically, the proposed new paragraph would provide that in conducting a risk assessment for each office or location, a member would be required to consider, among other things: (1) the volume and nature of customer complaints; (2) the volume and nature of outside business activities, particularly

¹⁶ See Proposal, 87 FR 50144, 50148.

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. In addition, proposed new paragraph (b)(2) would further provide that consistent with Rule 3110.12, members should conduct on-site inspections or make more frequent use of unannounced, on-site inspections for high-risk locations or where there are "red flags."

FINRA expects a firm to carefully consider the proposed factors listed above and Rule 3110.12 for the risk assessment. The outcome of such assessment may raise red flags that should prompt a firm to consider, among other things, inspecting, remotely or on-site, its offices or locations more frequently than the schedule set forth under Rule 3110(c)(1) (on an announced or unannounced basis). Moreover, FINRA notes that Rule 3130 (Annual Certification of Compliance and Supervisory Processes) requires member firms to have processes to establish, maintain, review, test, and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable FINRA rules, Municipal Securities Rulemaking Board rules, and federal securities laws and regulations. FINRA expects firms to consider Rule 3110.18 as part of their Rule 3130 annual certification process.

Proposed Additional Firm-Level Exclusions and Conditions

Under the Proposal, some member firms and their offices or locations would be excluded from participating in the proposed pilot program based on events or activities of a member firm or its associated persons that FINRA believes are more likely to raise investor protection concerns based on the firm's or an associated person's record of specified regulatory or disciplinary events. Specifically, a member firm would be ineligible to conduct remote inspections of any of its offices or locations if any time during the period of the proposed pilot program the member is or becomes designated as a Restricted Firm under Rule 4111 or designated as a Taping Firm under Rule 3170.

In light of the comments, with Partial Amendment No. 1, FINRA is proposing to expand the list of events that would deem a member firm ineligible to participate in the proposed pilot program to include a member firm that:

- (1) receives a notice from FINRA under Rule 9557 (Procedures for Regulating Activities Under Rules 4110, 4120 and 4130 Regarding a Member Experiencing Financial or Operational Difficulties) under Rule 4110 (Capital Compliance), Rule 4120 (Regulatory Notification and Business Curtailment) or Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties), unless FINRA has otherwise permitted activities in writing pursuant to such rule;
- (2) is or becomes suspended by FINRA;

- (3) based on the date in the Central Registration Depository (CRD) had its FINRA membership become effective, within the prior 12 months; or
- (4) is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c).¹⁷

FINRA believes that a member firm that is experiencing issues complying with its capital requirements or has been suspended by FINRA is more likely to face significant operational challenges that may negatively impact the firm's inspection program. FINRA further believes that a firm that has been a FINRA member for less than 12 months is often still implementing its business plan and may not have sufficient experience to develop a sufficiently robust inspection program. With respect to a firm that is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c), FINRA believes such firms have demonstrated challenges in developing or maintaining robust inspection programs. As such, FINRA believes that these proposed additional ineligibility criteria would appropriately limit the potential population of member firm pilot program participants to those firms that may be better positioned to conduct remote inspections. Moreover, FINRA believes these amendments more appropriately tailor the Proposal to maintain investor protection.

To further address commenters' concerns pertaining to the proposed controls of the pilot program, FINRA is proposing to enhance those controls with respect to books and records and surveillance and technology tools. Proposed new paragraph (c)(1)(B) to Rule 3110.18 pertaining to firm-level conditions would require:

¹⁷ For purposes of proposed Rule 3110.18, the meaning of "found" would align with Rule 4530.03 (Meaning of "Found."), which provides that the term "found" as used in paragraph (a)(1)(A) of Rule 4530, "includes among other formal findings, adverse final actions, including consent decrees in which the respondent has neither admitted nor denied the findings, but does not include informal agreements, deficiency letters, examination reports, memoranda of understanding, cautionary actions, admonishments and similar informal resolutions of matters. For example, a Letter of Acceptance, Waiver and Consent or an Order Accepting an Offer of Settlement is considered an adverse final action. The term "found" also includes any formal finding, regardless of whether the finding will be appealed. The term "found" does not include a violation of a self-regulatory organization rule that has been designated as "minor" pursuant to a plan approved by the SEC, if the sanction imposed consists of a fine of \$2,500 or less, and if the sanctioned person does not contest the fine."

- (1) (a) the member to have a recordkeeping system to make and keep current, and preserve records required to be made and kept current, and preserved under applicable securities rules and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110; (b) such records are not physically or electronically maintained and preserved at the office or location subject to the remote inspection; and (c) the member has prompt access to such records; and
- (2) as part of the requirement to develop a reasonable risk-based approach to using remote inspections, and the further requirement to conduct and document a risk assessment for each office or location, the member must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each such office or location. These tools may include but are not limited to: (a) firm-wide tools such as, electronic recordkeeping system; electronic surveillance of e-mail and correspondence; electronic trade blotters; regular activity-based sampling reviews; and tools for visual inspections; (b) tools specific to that office or location based on the activities of associated persons, products offered, restrictions on the activity of the office or location (including holding out to customers and handling of customer funds or securities); and (c) system tools such as secure network connections and effective cybersecurity protocols.

FINRA believes these proposed new eligibility conditions are appropriate to establish reasonable baseline requirements for remote inspections.

Proposed Additional Location-Level Exclusions and Conditions

Under the Proposal, a member firm would not be able to remotely inspect a specific office or location in accordance with proposed Rule 3110.18 if at any time during the period of the proposed pilot program: one or more associated persons at such office or location is or becomes subject to a mandatory heightened supervisory plan; one or more associated persons at such office or location is or becomes statutorily disqualified; the firm is or becomes subject to Rule 1017(a)(7) as a result of one or more associated persons at such office or location;¹⁸ or one or more associated persons at such office or location

¹⁸ In general, paragraph (a)(7) of Rule 1017 (Application for Approval of Change in Ownership, Control, or Business Operations) requires a member firm to file an application for continuing membership when a natural person seeking to become an owner, control person, principal or registered person of the member firm has, in the prior five years, one or more defined "final criminal matters" or two or more "specified risk events" unless the member firm has submitted a written request to FINRA seeking a materiality consultation for the contemplated activity. Rule

answers “yes” to specified questions in Form U4 (Uniform Application for Securities Industry Registration or Transfer).¹⁹

To address concerns about the discretion the Proposal would provide to firms to make risk assessments of the criteria specified earlier of their offices or locations, with Partial Amendment No. 1, FINRA is proposing to expand the list of events or activities that would deem a specific office or location of a member ineligible from participating in the pilot program to include an office or location at which:

- (1) one or more associated persons at such office or location is or becomes subject to a disciplinary action taken by the member that is or was reportable under Rule 4530(a)(2); or
- (2) one or more associated persons at such office or location is a part of the member’s trading desk (e.g., engaging in market making activities or having authority to enter proprietary trades on behalf of the member or as agent for other parties); or
- (3) the office or location handles customers’ funds or securities.

FINRA believes the expanded list of exclusions for specific offices or locations of a member further strengthens the terms of the proposed pilot program by identifying additional offices or locations that may particularly benefit from in-person inspections and expressly excluding them, regardless of any individual firm’s risk assessment. With respect to item (1), Rule 4530(a)(2) requires a member firm to report when an associated person of the member is the subject of any disciplinary action taken by the member involving suspension, termination, the withholding of compensation or of any other remuneration in excess of \$2,500, the imposition of fines in excess of \$2,500 or is otherwise disciplined in any manner that would have a significant limitation on the individual’s activities on a temporary or permanent basis. FINRA believes that where a member firm has determined that its associated person should be subject to any of the disciplinary actions outlined above, it reasonably follows that the activities of such

1017(a)(7) applies whether the person is seeking to become an owner, control person, principal or registered person at the person’s current member firm or at a new member firm. See generally Regulatory Notice 21-09 (March 2021) (announcing FINRA’s adoption of rules to address brokers with a significant history of misconduct).

¹⁹ See generally proposed Rule 3110.18(b)(2)(B)(i) through (iv) in the Proposal, renumbered as proposed Rule 3110.18(c)(2)(A)(i) through (iv) in Partial Amendment No. 1.

associated person and their office or location should reasonably require in-person oversight by the firm and, as such, requiring an on-site inspection under Rule 3110(c) remains appropriate.

With respect to items (2) and (3), FINRA believes that the functions of a member's trading desk and handling customers' funds or securities are significant activities potentially impacting the operations and financial stability of the firm and, as a result, may also significantly impact customers and the markets generally. In guidance pertaining to the branch office definition and the locations excluded from the definition, FINRA described, among other things, the circumstances under which a non-branch location (e.g., a primary residence) may accept customer funds or securities consistent with the condition that "[n]either customer funds nor securities are handled at the location."²⁰ In accordance with existing guidance, the meaning and interpretation of the term "handled" that currently appears in Rule 3110(f)(2)(A)(ii) would remain consistent in the proposed pilot program.²¹

In addition, the processes involved in these activities may at the present time benefit from in-person inspections. Therefore, FINRA believes these offices or locations should not be eligible for remote inspections under the proposed pilot program and would be required to be inspected on-site in accordance with current Rule 3110(c).

To further address commenters' concerns regarding the proposed pilot program's controls, FINRA is proposing to add three new eligibility conditions to conduct a remote inspection during the pilot period:

- (1) electronic communications (e.g., e-mail) are made through the member's electronic system;
- (2) the associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with Rule 3110; and
- (3) no books or records of the member required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110 are physically or electronically maintained and preserved at such office or location.

²⁰ See Rule 3110(f)(2)(A)(ii)c.

²¹ See Question and Answer 8 in Notice to Members 06-12 (March 2006).

Public Interest Determination of Ineligibility

FINRA is also proposing to adopt new paragraph (k) to proposed Rule 3110.18 to allow FINRA to make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the proposed pilot program if the member fails to comply with the requirements of Rule 3110.18. If warranted, FINRA would provide written notice to the member of such determination and such member would no longer be eligible to participate in the proposed pilot program and would be required to conduct on-site inspections of required offices and locations in accordance with Rule 3110(c). FINRA believes this added authority would both align with FINRA's examination and risk monitoring programs for member firms and registered persons and allow FINRA to more effectively assess higher risk.

Surveillance and Technology Tools

Many commenters share the view that advances in technology have facilitated remote surveillance, including inspections, with some commenters describing the technology that they leverage to effectively surveil and inspect offices and locations remotely.²² Examples include the use of laptops connected to the firm's network; smart phones for live video calls; video conferencing technology; electronic notifications of shipments to and from an office or location; and internet searches of social media and public records.²³ NASAA, however, expresses concern with the Proposal's lack of detail on the technology firms use noting, among other things, that the Proposal does not describe with specificity the technologies being used by firms to conduct effective remote surveillance, provide sufficient data about the level to which such technologies are actually being used, and whether firms of all size use such technologies.²⁴ Cornell shares similar concerns.

As stated in the Proposal, FINRA continues to believe that technological improvements and developments in regulatory compliance have provided significant tools to create more effective and efficient compliance programs. As noted above, several commenters describe the technologies they use to effectively surveil and conduct remote

²² See ASA, Cambridge, Cetera, Davidson, Finalis, Group of 16, Integrated Solutions, LPL I, MMLIS, SIFMA I, Szaro, Vanguard.

²³ See Cambridge, Group of 16, SIFMA I, Szaro.

²⁴ See also NASAA II (stating, in general, that the Proposal should establish minimum technological capabilities as a prerequisite for participating in the proposed pilot program).

inspections.²⁵ SIFMA notes that “the tools, for example, to perform remote inspections are basic, from a cloud account to upload documents to review, smart phones, video conferencing services, and publicly available resources.”²⁶ The Group of 16 indicates that through feedback from the consultants and other members firms of various sizes, “the most popular tools they use for remote inspections are the tools most people already have and are familiar with using- virtual meeting programs and smart phones/devices.” Szaro states that “[t]he methods and tools to conduct inspections in a remote capacity can be better described as a creative approach rather than a high-priced expenditure.” (Citation omitted).

Some commenters state that much of the work associated with the inspection process is done electronically through the firm’s surveillance systems before visiting the office or location, leaving little to review once there.²⁷ For example, Wells Fargo states that “as key technology and systems have improved, most branch inspection activities are now completed prior to the on-site phase of the branch inspection. In fact, prior to the onset of the pandemic, approximately 90% of the WIM branch-office-inspection process was completed remotely prior to conducting an on-site visit.” SIFMA states that firms of all sizes indicate that “80 to 85 percent of their inspections are conducted in preparatory work utilizing the firm’s surveillance systems and other technologies.”

While FINRA does not believe that it would be appropriate to identify specific technologies for the proposed pilot program because of the evolving development of and ongoing advances in technologies, as described above, FINRA is modifying the Proposal to add proposed new paragraph (c)(1)(B) to Rule 3110.18 that would require a member firm, as part of the risk assessment that occurs before a firm elects to use remote inspections, to determine if its surveillance and technology tools are appropriate to supervise the types of risks presented by each office or location. FINRA believes that the failure to have adequate surveillance and technology tools would raise questions about the reasonableness of remote inspections.

Reasonably Designed Supervisory System

Adequacy of Risk-Based Principles

Under the Proposal, a firm that elects to participate in the proposed pilot program must adopt written supervisory procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with applicable

²⁵ See Cambridge, Group of 16, SIFMA I, Szaro.

²⁶ See SIFMA III.

²⁷ See Cambridge, Davidson, FSI I, SIFMA I, WFC.

securities laws and regulations, and with applicable FINRA rules.²⁸ Such procedures should include, among other things, a description of the methodology, including technology, that may be used to conduct remote inspections; the factors considered in the risk assessment made for each applicable office or location pursuant to specified terms therein; and the use of other risk-based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.

NASAA criticizes these proposed provisions because they are principles-based and do not provide any prescriptive details about “how rigorous [the] policies and procedures must be in order to pass muster.” NASAA views some of the language in proposed Rule 3110.18,²⁹ which contains language that is substantially similar to Rule 3110.17 and modeled in part on Rule 3110.12, as “tepid” and “vague.”³⁰ As such, NASAA recommends that more prescriptive terms be required.³¹ Cornell also shares concerns about the proposed language.

FINRA views NASAA’s characterization of the principles-based language in proposed Rule 3110.18 as misplaced. The core tenet of Rule 3110 is for a member firm to have a “reasonably designed” supervisory system, including written supervisory procedures, to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.³² FINRA emphasizes that the Proposal is not intended to change this tenet. The Proposal would reiterate the importance of Rule 3110(b) for members to “establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.”

²⁸ See generally proposed Rule 3110.18(c) (Written Supervisory Procedures for Remote Inspections) in the Proposal, renumbered as proposed Rule 3110.18(d) (Written Supervisory Procedures for Remote Inspections) in Partial Amendment No. 1.

²⁹ See generally proposed Rule 3110.18(d) (Effective Supervisory System) in the Proposal, renumbered as proposed Rule 3110.18(e) (Effective Supervisory System) in Partial Amendment No. 1.

³⁰ See NASAA I, NASAA II.

³¹ See NASAA II.

³² See generally Rule 3110(a) (Supervisory System) and Rule 3110(b) (Written Procedures).

Subject to technical changes, FINRA is retaining the written supervisory procedures provisions in the Proposal.³³ Moreover, FINRA believes that proposed Rule 3110.18(b)³⁴ would provide the appropriate guardrails. Proposed Rule 3110.18(b)(1)³⁵ would require a firm to consider the factors set forth under Rule 3110.12 (e.g., scope of business activities, disciplinary history of registered persons or associated persons), and take into account higher risk activities that occur at the office or location, or higher risk associated persons assigned to such office or location. In addition, as described above, proposed new paragraph (b)(2) would include additional factors a firm must consider such as the nature of the customer base, including vulnerable adult investors, and whether associated persons are subject to heightened supervision. Further, under the proposed data and information collection requirement, a firm would be required to provide FINRA written supervisory procedures for remote inspections relating to the escalation of significant findings, new hires, brokers with a significant history of misconduct, and outside business activities and “doing business as” designations.³⁶

Inspections as Part of a Reasonably Designed Supervisory System

NASAA states it is unconvinced that an inspection of an office or location without an on-site visit may be done effectively. NASAA believes the proposed approach to allow a firm to conduct its own risk assessment as to whether a particular office or location should be inspected remotely signals to firms that they may abandon in-person inspections, and because the Proposal would “[ease] inspection burdens on firms[,]” regulators would be forced to “[f]ill [g]aps [c]reated by [l]ax [f]irm [i]nspection [p]ractices.”³⁷ NASAA asserts that “meaningful in-person inspections must remain a part of every firm’s supervisory practices.”

NASAA provides several anecdotal examples of misconduct it believes could be found only through an on-site inspection, not a remote inspection (e.g., a regulator

³³ See notes 28 and 29, *supra*.

³⁴ See proposed Rule 3110.18(b) (Use of Remote Inspections) in the Proposal, retitled as proposed Rule 3110.18(b) (Risk Assessments) in Partial Amendment No. 1.

³⁵ See proposed Rule 3110.18(b)(1) in the Proposal and in Partial Amendment No. 1.

³⁶ See proposed Rule 3110.18(f) (Data and Information Collection Requirement) in the Proposal, renumbered as proposed Rule 3110.18(g) (Data and Information Collection Requirement) in Partial Amendment No. 1.

³⁷ See also NASAA II (stating, in part, that “[i]f lax remote inspection practices become the norm, it will be difficult to bring them back up to an acceptable level, regardless of what the data ultimately suggests.”).

overhearing a sales pitch for securities not approved by the firm). PIABA believes that remote inspections “cannot uncover nefarious conduct by brokers who keep records in paper form and meet with clients in-person.”³⁸ SJU also contends that remote inspections will unlikely uncover misconduct that is effected through “very traditional means of communications” (e.g., paper-based communications and transactions). But two commenters note, based on their experience in conducting inspections, that the on-site inspection has increasingly become limited over the years and is no longer the primary tool to identify problematic activity. Vanguard notes that “[s]ome regulatory agencies have voiced concern that without in-person inspections firms have been incapable of identifying certain violations, including those related to the use of personal devices. However, as a practical matter, inspections are only a point-in-time approach to identifying issues or red flags. Certain ‘bad’ behaviors are more effectively identified and controlled through ongoing surveillance or activity-based sampling review, which can be accomplished remotely, particularly when paired with effective policies, training, and performance management mechanisms for ensuring compliance.” Fidelity shares the observation that “[a]s client engagement migrates to electronic interactions—particularly with younger investors who favor this mode of communication—[Fidelity expects] to find that any employee misconduct will migrate there as well.” Fidelity states that an on-site inspection may not be the most effective way to identify, for example, the use of personal devices or electronic communications through an email account.

FINRA emphasizes that an inspection conducted on the prescribed, non-risk-based schedule set forth in Rule 3110(c)(1) is a singular event that occurs in a calendar year. This inspection requirement is only one facet of a reasonably designed supervisory system—the inspection event alone does not bear the full weight of a member firm’s obligation to supervise all of its associated persons, regardless of location, compensation or employment arrangement, or registration status, in accordance with the FINRA By-Laws and Rules.³⁹ Many commenters also recognize that Rule 3110(c) is one component of a reasonably designed supervisory system.⁴⁰ As articulated in prior guidance, firms should continuously monitor their offices and locations with respect to “changes in the overall business,

³⁸ See also PIABA II (articulating a number of things that technology cannot detect but would be found through an in-person audit such as building signage, office-sharing with other professionals or businesses, the advisor’s car and personal belongings, and assessing generally whether an advisor is living within the advisor’s means).

³⁹ See generally Notice to Members 98-38 (May 1998) (guidance reminding firms of supervisory and inspection obligations).

⁴⁰ See Cetera, Fidelity, LPL I, SIFMA I, Vanguard, WFC.

products, people and practices” as part of an effective risk assessment process for inspections.⁴¹

Even though some commenters articulate the limited utility of conducting on-site inspections, several other commenters indicate there will remain circumstances in which on-site inspections may be beneficial or even should be mandatory.⁴² For example, MMLIS states that inspections “should continue to be mandatory for locations with customer-facing activity or custody of customers’ funds or securities.” Liberty Capital states that a remote inspection “is not something [it] would necessarily always choose to do, but when an employee lives and works out of state, having this option would be beneficial to small firms.” The Group of 16 states that “[m]ember firms who plan to opt-in to the Pilot Program expressed that they still foresee a mix of conducting inspections in-person and remotely.” In addition, Wells Fargo notes that it “will continue to value on-site inspections as a component of our supervisory framework consistent with a risk-based approach.”

Commenters also note that the proposed pilot program would help firms better allocate their compliance resources to higher risk areas and supervision generally.⁴³ For example, SJU conveys a qualified appreciation that the Proposal would allow firms “to focus on inspections regarding high-risk locations. By streamlining the inspection process for low-risk firms and low-risk locations, more time and money can be invested into protecting investors from high-risk brokers and high-risk locations.” Raymond James states that “[w]ith the ability to utilize risk assessments in the determination of onsite versus remote inspections, firms can better align resources to higher risk areas.” Cambridge states that remote inspections would allow firms to “allocate the time and cost savings to enhance their supervision procedures . . . the time, cost, and employee benefits associated with permitting remote inspections will allow member firms to better allocate their resources toward supervision of branch offices.”

FINRA affirms that the Proposal is not intended to “signal” the abandonment of on-site inspections, but to provide another way, subject to specified controls described herein

⁴¹ See Regulatory Notice 11-54 (November 2011).

⁴² See Cambridge, Cetera, CFN, Group of 16, Liberty Capital, LPL I, MMLIS, SIFMA I, Szaro, WFC. See also Regulatory Notice 21-44 (December 2021) (“Notice 21-44”) (describing lessons learned from the pandemic in a variety of areas including remote inspections with some stakeholders emphasizing the value of on-site inspections).

⁴³ See Cambridge, Cetera, CFN, Fidelity, Liberty Capital, Raymond James, SJU, Szaro.

and in Partial Amendment No. 1, for firms to meet their inspection obligations. As noted above, FINRA expects a firm to consider various factors as part of the risk assessment of its offices or locations. Such assessment may reveal red flags and should prompt a firm to consider, among other things, inspecting, remotely or on-site, those offices or locations more frequently, on an announced or unannounced basis, than the prescribed, non-risk-based schedule under Rule 3110(c)(1). Subject to the proposed specified controls, the proposed pilot program is intended to gauge the effectiveness of remote inspections as part of a reasonably designed supervisory system that may provide a path towards modernizing Rule 3110(c).

Monitoring for Compliance with Proposed Rule 3110.18

General Compliance with the Proposed Pilot Program

The Proposal would provide that a member firm that fails to satisfy the conditions of proposed Rule 3110.18, including the data and information collection requirement, would be ineligible to participate in the pilot program and must then conduct on-site inspections in accordance with Rule 3110(c).

NASAA expresses concern with how FINRA will generally monitor for firm compliance with proposed Rule 3110.18 beyond a firm's failure to provide data and information. Similarly, SJU conveys that FINRA should ensure that it conducts on-site examinations of firm pilot participants to determine the effectiveness of remote inspections.

FINRA notes that its Examination and Risk Monitoring programs are a critical component of FINRA's regulatory operations and one of the primary means by which FINRA oversees the activities of its member firms. The implementation of proposed Rule 3110.18 would not change FINRA's well established approach to firm oversight. As with any new rule, FINRA's risk-based examination program will conduct reviews for firms' compliance with this new rule. In addition, FINRA will utilize the data provided by pilot participants to conduct trend analysis and determine if further regulatory review of any particular pilot participant firm is warranted. FINRA will also consider, based on the results of its regulatory efforts, publishing effective practices and common findings in this area.

The Meaning of "Significant Findings" for Purposes of Data and Information Collection

Proposed Rule 3110.18 would specify the data and information a member firm pilot participant must provide to FINRA on a periodic basis as a pilot program participant. Among the data is the number of findings identified through a remote inspection and an on-site inspection, and a list of the most "significant findings." MMLIS asks for an example of a "significant finding" and TIAA asks whether finding is "significant" because of a firm's assessment of severity, the frequency of occurrence, or some other criterion.

FINRA clarifies that a “significant finding” would be one that should prompt the firm to take further action that could include escalation to the appropriate channels at the firm for further review, the result of which may be enhanced monitoring or surveillance of a particular event or activity through more frequent inspections (remotely or on-site), on an announced or unannounced basis, of the office or location, or other targeted reviews of the root cause of the finding. Examples of some findings that may prompt escalation or further internal review by the appropriate firm personnel include, among other things, the use of unapproved communication mediums, customer complaints, or undisclosed outside business activities or private securities transactions.

Obtaining Data About Remote Inspections as a Condition Precedent to Establishing a Remote Inspection Pilot Program

NASAA and Cornell oppose the Proposal on the basis that data pertaining to remote inspection practices are needed before establishing a voluntary, three-year pilot program in a hybrid work environment.⁴⁴ Cornell contends that a “comprehensive data analysis process” about remote inspections during office shutdowns needs to precede the establishment of a voluntary pilot program. Cornell believes that FINRA could have, during the pandemic, “collated that data and made a more comprehensive case for permanent virtual supervision.”

With the evolving nature of the pandemic and shifts in associated person locations, collecting data from firms relying on temporary Rule 3110.17 to conduct remote inspections presented issues with respect to both the standardization and timing of any such data.⁴⁵ A key objective of the data reporting requirements in the proposed pilot program is

⁴⁴ NASAA also provides views on the proposed data and information requirement specifying a quarterly data requirement, requesting a list of “all findings” rather than permitting firms to provide the “most significant” findings, and specifying that the procedures include any other procedures related to conducting and documenting the risk assessment and remote inspections, and documenting the findings. See NASAA II. As described above, proposed Rule 3110.18 would address the requirements of reasonably designed procedures for remote inspections. Further, and as described below, FINRA believes that the data and collection requirement, as proposed, will help in the effort to form effective practices in this area and assess the potential opportunity to modernize Rule 3110(c).

⁴⁵ Temporary Rule 3110.17 provides member firms the option, subject to specified conditions therein, to complete their Rule 3110(c) inspection obligations remotely. FINRA has extended this provision through the earlier of the effective date of the Proposal, if approved, or through December 31, 2023. See Securities Exchange Act

to provide FINRA the type of structured data it needs to study trends and firms' experiences with their remote inspection programs in a hybrid work environment. Other commenters note this purpose, which is not uncommon for a pilot program.⁴⁶ SIFMA states that "the purpose of any pilot program is to collect precisely this type of information so that stakeholders can make informed decisions on regulatory modernization proposals."⁴⁷ In addition, the Group of 16 states that the data collected through the proposed pilot program would "enable FINRA to systematically assess the overall impact on firms' supervisory systems, which has not been feasible with information drawn from the pandemic-related office shutdowns." WFC recognizes that the proposed pilot program would allow FINRA to assess the effectiveness of remote inspections.

The Proposal was informed by various outreach and engagement efforts with member firms, many of which have communicated to FINRA their overall experiences with remote inspections, including the technology used.⁴⁸ These experiences are reflected in some of the comments received to the Proposal.⁴⁹ For example, some commenters report that they did not experience a significant variance in findings derived from pre-pandemic on-site inspections versus remote inspections.⁵⁰ Cetera states that it conducted more than 3,000 in-person branch inspections during the pre-pandemic period (2017–2019) and reports that it was able to "locate only a few instances in which wrongful conduct was first identified during an in-person branch inspection, and [believes] that the conduct at issue would have been identified through other means in almost all cases." Cetera makes it clear that by making such statement, it does not claim that its inspection program "is perfect[.]" but notes that "the number of instances in which improper activity has been discovered through review of email and other electronic communications, surveillance of transaction activity, and direct contact with customers or other members of the public vastly outnumbers matters identified during branch inspections." Fidelity provides data noting that "[c]omparing findings from the nearly 900 on-site branch inspections [it] conducted during the pre-pandemic period (2017–2019) to the nearly 600 remote branch inspections conducted during the pandemic (March 2020–December 2021), the findings

Release No. 96241 (November 4, 2022), 87 FR 67969 (November 10, 2022)
(Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-030).

⁴⁶ See Group of 16, SIFMA I, WFC.

⁴⁷ See SIFMA II.

⁴⁸ See, e.g., FINRA Virtual Conference Panels, Remote Inspections (February 11, 2021), <https://www.finra.org/virtual-conference-panels/video-remote-inspections>.

⁴⁹ See Cetera, CFN, Davidson, Fidelity, MMLIS, TIAA, Vanguard, WFC.

⁵⁰ See Cetera, Davidson, Fidelity, MMLIS, Vanguard.

were both comparable and de minimis.” While CFN also reports a similar experience, it cautions that the offices or location that undergo remote inspections may yield fewer findings simply because of their lower risk profile rather than evidence that on-site inspections are more effective than remote inspections.

In the course of FINRA’s recent oversight of member firms, FINRA has observed some effective practices used for remote inspections that include proactive reviews for undisclosed outside business activities through searches in publicly available resources, written supervisory procedures that describe a firm’s remote inspection program, and the technology used to facilitate remote inspections (e.g., use of video conferencing technology, screen-sharing, monitoring and testing device usage, device security). FINRA believes that the proposed pilot program would be an appropriate means to collect data and information in a structured, uniform manner that may show a more comprehensive range of feedback in the context of a hybrid work environment. Moreover, FINRA believes that the standardized data collected through the proposed pilot program would help form effective practices in this area and assess the potential opportunity to modernize Rule 3110(c).

Other Topics

Rule 3110(b)(4) (Review of Correspondence and Internal Communications)

PIABA raises concerns with risk-based review of electronic communications, which is addressed in Rule 3110(b)(4). In general, Rule 3110(b)(4) requires a firm to have supervisory procedures, which are appropriate for the firm’s business, size, structure and customers, to review incoming and outgoing written (including electronic) correspondence and internal communications relating to its investment banking or securities business. Rule 3110.06 (Risk-based Review of Correspondence and Internal Communications) codifies the principles-based guidance provided in Regulatory Notice 07-59 (December 2007) (“Notice 07-59”) regarding the supervision of electronic communications. Among other things, the guidance describes several methods of review that may include lexicon-based reviews and random reviews that use a reasonable percentage sampling technique for which there is no prescribed minimum or fixed percentage. PIABA is concerned that firms may only review a sampling of electronic correspondence and therefore fail to detect problematic activity.⁵¹ PIABA states that “regardless of whether the pilot program is implemented or not, the Commission should demand that FINRA require firms to review

⁵¹ See also PIABA II (reiterating concern with “the existing scheme for surveillance of electronic [communications]” in which firms “review a sampling of emails or electronic messages, leaving opportunities for bad actors to make improper sales presentations or commitments to clients via email or text so long as those messages do not trigger the key words used to flag potentially problematic communications.”).

more than just a sampling of electronic correspondence.” The Proposal does not seek to amend Rule 3110(b)(4) relating to requirements for the review of correspondence and internal communications. As such, FINRA believes this comment is beyond the scope of the Proposal. However, FINRA reminds firms that the “path towards an effective supervisory system starts with clear policies and procedures for the general use and supervision of electronic communications, both internal and external, which are updated to address new technologies.”⁵² As part of an effective supervisory system, and in accordance with well-established risk-based principles for correspondence review, a firm that conducts remote inspections of its offices or locations should engage in an ongoing evaluation of the frequency of reviews and sampling techniques of communications to review by considering the proposed factors underlying the risk assessment as well as geographical location of activities, and volume of communications, among other factors.⁵³

Other Topics

Several commenters share views in other areas that are outside the scope of the Proposal,⁵⁴ such as privacy concerns associated with displaying the street address of residential locations on FINRA’s BrokerCheck[®] tool,⁵⁵ and a potential reevaluation of the definitions of OSJ and branch office under Rule 3110(f).⁵⁶ FINRA acknowledges the comments raised in these areas and will consider these comments as part of future rulemaking, as appropriate. In addition, some commenters express their views on the inspection requirement under Rule 3110(c) generally in light of the advances in communications and other technology, and risk profile.⁵⁷ For example, Raymond James requests that locations at which permissively registered persons (e.g., compliance, legal and human resources) with non-sales clerical staff, and where only supervisory activities are performed be exempt from the inspection requirement altogether because the functions do not carry the same risk of misconduct or customer harm as the locations at which there is customer-facing activities. FINRA notes that the Proposal would not exempt any office or location from the inspection requirement.⁵⁸ However, FINRA acknowledges the comments

⁵² See Notice 07-59

⁵³ See Notice 07-59

⁵⁴ See ASA, Fidelity, Group of 16, Integrated Solutions, NASAA I, SIFMA I.

⁵⁵ See Group of 16.

⁵⁶ See Fidelity.

⁵⁷ See Fidelity, Integrated Solutions, Raymond James, SIFMA I.

⁵⁸ See proposed Rule 3110.18(b)(1) in the Proposal and in Partial Amendment No. 1.

raised in this area, and will consider these comments as part of future rulemaking for a permanent rule on remote inspections, as appropriate. Some commenters also take the opportunity to respond to the RSL Proposal,⁵⁹ which FINRA addressed in its response to comments to that proposal.⁶⁰

Finally, NASAA raises concerns with the “rushed manner” in which the Proposal has been presented and contends that by not going through its regulatory notice process, FINRA has “precluded the ability of all stakeholders to engage in reasoned and thoughtful consideration of the [Proposal].” FINRA disagrees with this assertion. Since the onset of the pandemic, FINRA has been fully engaged with a host of stakeholders about pandemic-related regulatory and operational issues,⁶¹ and has extended temporary Rule 3110.17 to provide regulatory continuity in an uncertain environment and mitigate the potential burden and costs of reverting to an on-site inspection program while the prospect of a remote inspections pilot program is pending Commission review. As noted above, a key objective of the proposed pilot program is to collect structured data and information in the context of a hybrid work environment to help form the basis for a potential permanent rule for remote inspections.

SEC Action

Several commenters urge the SEC to adopt this Proposal and the RSL Proposal concurrently and before December 31, 2022.⁶² NASAA suggests the SEC disapprove the Proposal and the RSL Proposal, and instead extend Rule 3110.17 for one year so that FINRA may: “(1) conduct an examination sweep (under the SEC’s supervision) to determine the ubiquity and effectiveness of remote supervision policies, procedures, practices and technologies across a wide sample of FINRA member firms; (2) issue a public report that describes FINRA’s methods, findings and any recommendations for changes and improvements that could ensure effective remote supervision generally; and (3) based on the record developed, engage in full rulemaking processes for any subsequent

⁵⁹ See ASA, Group of 16, NASAA I, SIFMA I.

⁶⁰ See Letter from Kosha Dalal, Vice President and Associate General Counsel, FINRA, to Vanessa Countryman, Secretary, SEC, dated October 31, 2022 (responding to comments submitted for the RSL Proposal).

⁶¹ See, e.g., Notice 21-44, and Regulatory Notices 20-42 (December 2020); 20-16 (May 2020); and 20-08 (March 2020).

⁶² See ASA, Cetera, Davidson, Group of 16, MMLIS, Raymond James, SIFMA I, TIAA.

proposals, which would include FINRA regulatory notice and comment periods followed by SEC notice and comment periods.”⁶³

FINRA appreciates the need for regulatory clarity and has adopted an amendment to Rule 3110.17 to extend the temporary relief to conduct remote inspections through the earlier of the effective date of the proposed pilot program, if approved, or December 31, 2023.⁶⁴

* * * * *

FINRA believes that the foregoing responds to the material issues raised by the commenters to the rule filing and has determined not to amend the Proposal in response to comments. If you have any questions, please contact me at (202) 728-6903, email: Kosha.Dalal@finra.org.

Best regards,

/s/ Kosha Dalal

Kosha Dalal
Vice President and Associate General Counsel
Office of General Counsel

⁶³ See also NASAA II (reiterating the view that the Commission should reject the Proposal and require FINRA to conduct an examination sweep, publish a report of its findings, and then offer a proposal based on the findings).

⁶⁴ See note 45, supra.

Attachment A: Alphabetical List of Commenters to File No. SR-FINRA-2022-021

1. Helen Barnhill, Teachers Insurance and Annuity Association of America (“TIAA”) (September 6, 2022)
2. Jacqueline A. Beauprez & Brian Zellner, D.A. Davidson & Co. (“Davidson”) (September 6, 2022)
3. David T. Bellaire, Financial Services Institute (“FSI I”) (September 6, 2022)
4. Peggy E. Chait & Howard Spindel, Integrated Solutions (“Integrated Solutions”) (September 5, 2022)
5. Mackenzie Connick & Christine Lazaro, St. John’s University School of Law (“SJU”) (September 6, 2022)
6. Michael S. Edmiston, Public Investors Advocate Bar Association (“PIABA I”) (September 6, 2022)
7. Erica Green, Vanguard Marketing Corporation (“Vanguard”) (September 6, 2022)
8. Christopher A. Iacovella, American Securities Association (“ASA”) (September 6, 2022)
9. William A. Jacobson & Dustin Hartuv, Cornell Securities Law Clinic (“Cornell”) (September 6, 2022)
10. Clifford Kirsch & Eric Arnold, Eversheds Sutherland (US) LLP for the Committee of Annuity Insurers (“CAI I”) (September 6, 2022)
11. Melanie Senter Lubin, North American Securities Administrators Association, Inc. (“NASAA I”) (August 23, 2022)
12. Gavin Lucca, Commonwealth Financial Network (“CFN”) (September 6, 2022)
13. Jim McHale & Robert Mulligan, Wells Fargo & Company (“WFC”) (September 6, 2022)
14. Gail Merken, Janet Dyer & John McGinty, Fidelity Investments (“Fidelity”) (September 6, 2022)
15. Seth Miller, Cambridge Investment Research, Inc. (“Cambridge”) (September 6, 2022)
16. Dee O’ Neill, Raymond James & Associates, Inc. (“Raymond James”) (September 6, 2022)
17. Mark Quinn, Cetera Financial Group, Inc. (“Cetera”) (September 6, 2022)

18. Stefanie Reel, Liberty Capital Investment Corp. (“Liberty Capital”) (September 1, 2022)
19. Mark Seffinger, LPL Financial, (“LPL I”) (September 6, 2022)
20. Mark Seffinger, LPL, (“LPL II”) (October 25, 2022)
21. Karol Sierra-Yanez, MML Investors Services, LLC (“MMLIS”) (September 6, 2022)
22. Jennifer L. Szaro, (“Szaro”) (September 6, 2022)
23. Jennifer L. Szaro, XML Securities, LLC (“Group of 16”) (October 25, 2022)
24. Justine Tobin, Tobin & Company Securities LLC (“Tobin”) (September 6, 2022)
25. Kevin Zambrowicz & Bernard V. Canepa, Securities Industry and Financial Markets Association (“SIFMA I”) (September 6, 2022)
26. Kevin Zambrowicz & Bernard V. Canepa, SIFMA (“SIFMA II”) (September 30, 2022)
27. Kevin Zambrowicz & Bernard V. Canepa, SIFMA (“SIFMA III”) (October 19, 2022)
28. Brad Ziemba, Finalis Securities LLC (“Finalis”) (September 5, 2022)

Exhibit 2d

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * <input type="text" value="2"/>	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No. * SR <input type="text" value="2022"/> - * <input type="text" value="021"/> Amendment No. (req. for Amendments *) <input type="text"/>
Filing by Financial Industry Regulatory Authority		
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934		
Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input checked="" type="checkbox"/>
Caution: You are withdrawing this filing		
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>
Rule		
<input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(4) <input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(5) <input type="checkbox"/> 19b-4(f)(3) <input type="checkbox"/> 19b-4(f)(6)		
Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 Section 806(e)(1) * <input type="checkbox"/>		Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 Section 3C(b)(2) * <input type="checkbox"/>
Exhibit 2 Sent As Paper Document <input type="checkbox"/>		Exhibit 3 Sent As Paper Document <input type="checkbox"/>
Description Provide a brief description of the action (limit 250 characters, required when Initial is checked *). <div style="border: 1px solid black; padding: 5px; min-height: 40px;"> Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision) </div>		
Contact Information Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.		
First Name * <input type="text" value="Sarah"/>		Last Name * <input type="text" value="Kwak"/>
Title * <input type="text" value="Associate General Counsel"/>		
E-mail * <input type="text" value="sarah.kwak@finra.org"/>		
Telephone * <input type="text" value="(202) 728-8471"/>		Fax <input type="text"/>
Signature Pursuant to the requirements of the Securities Exchange of 1934, Financial Industry Regulatory Authority has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.		
Date <input type="text" value="04/11/2023"/>	(Title *)	
By <input type="text" value="Kosha Dalal"/> <small>(Name *)</small>	<input type="text" value="Vice President and Associate General Counsel"/>	
NOTE: Clicking the signature block at right will initiate digitally signing the form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.		
<div style="border: 1px solid black; padding: 5px; display: inline-block;"> Kosha Dalal <small>Digitally signed by Kosha Dalal Date: 2023.04.11 15:13:49 -04'00'</small> </div>		

Required fields are shown with yellow backgrounds and asterisks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFS website.

Form 19b-4 Information *

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3).

Exhibit 1A - Notice of Proposed Rule Change, Security-Based Swap Submission, or Advanced Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3).

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

☐ Exhibit Sent As Paper Document

Exhibit 3 - Form, Report, or Questionnaire

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

☐ Exhibit Sent As Paper Document

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

EXHIBIT 5

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

3100. SUPERVISORY RESPONSIBILITIES

3110. Supervision

(a) through (f) No Change.

• • • **Supplementary Material:** -----

.01 through .17 No Change.

.18 Remote Inspections Pilot Program

(a) Scope. This Supplementary Material establishes a Remote Inspections Pilot Program with respect to the required inspection of OSJs, branch offices and non-branch locations pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110. The Remote Inspections Pilot Program shall cover required inspections of such offices or locations for a period of three years starting on [insert effective date] ("pilot period"), and such pilot period shall expire on [insert date that is three years after effective date]. If the pilot period is not extended or Rule 3110.18, as may be amended, is not approved as permanent by the Commission, this Supplementary Material will automatically sunset on [insert date that is three years after effective date]. Members will not be able to participate in the Remote Inspections Pilot Program after such date.

(b) Risk Assessment

(1) Standards for Reasonable Review. Subject to paragraphs (c), (f) and (g) of this Supplementary Material, each member obligated to conduct an inspection of an office or location pursuant to, as applicable, paragraphs (c)(1)(A),

(B) and (C) under Rule 3110 may, subject to the requirements of this Rule 3110.18, elect to conduct the applicable inspection remotely, without necessarily an on-site visit for an office or location, when the member reasonably determines that the purposes of this Supplementary Material can be accomplished by conducting such required inspection remotely. Prior to electing a remote inspection for an office or location, rather than an on-site inspection, the firm must develop a reasonable risk-based approach to using remote inspections, and conduct and document a risk assessment for that office or location. The assessment must document the factors considered, including the factors set forth in Rule 3110.12 and must take into account any higher risk activities that take place at, or higher risk associated persons that are assigned to, that office or location. A member or its office or location that is ineligible for remote inspections because of either paragraphs (f) or (g) of this Supplementary Material must conduct an on-site inspection of that office or location on the applicable mandatory schedule under Rule 3110(c)(1). Notwithstanding Rule 3110.18, a member shall remain subject to the other requirements of Rule 3110(c).

(2) Other Factors to Consider for Risk Assessment. In addition to the requirements under paragraph (b)(1) of this Supplementary Material, a member shall consider, among other things, the following factors with respect to an office or location in making its risk assessment for remotely inspecting an office or location: (A) the volume and nature of customer complaints; (B) the volume and nature of outside business activities, particularly investment-related; (C) the volume and complexity of products offered; (D) the nature of the customer base,

including vulnerable adult investors; (E) whether associated persons are subject to heightened supervision; (F) failures by associated persons to comply with the member's written supervisory procedures; and (G) any recordkeeping violations. In addition, consistent with Rule 3110.12, members should conduct on-site inspections or make more frequent use of unannounced, on-site inspections for high-risk offices or locations or where there are indicators of irregularities or misconduct (i.e., "red flags").

(c) Written Supervisory Procedures for Remote Inspections. Consistent with a member's obligation under Rule 3110(b), a member that elects to participate in the Remote Inspections Pilot Program must adopt written supervisory procedures regarding remote inspections that are reasonably designed to detect and prevent violations of and achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. Reasonably designed procedures for conducting remote inspections of offices or locations must address, among other things: (1) the methodology, including technology, that may be used to conduct remote inspections; (2) the factors considered in the risk assessment made for each applicable office or location pursuant to paragraph (b) of this Supplementary Material; (3) the procedures specified in paragraph (h)(1)(G) and (h)(4) of this Supplementary Material; and (4) the use of other risk-based systems employed generally by the member to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.

(d) Effective Supervisory System. The requirement to conduct inspections of offices and locations is one part of the member's overall obligation to have an effective

supervisory system and therefore the member must maintain its ongoing review of the activities and functions occurring at all offices and locations, whether or not the member conducts inspections remotely. A member's use of a remote inspection of an office or location will be held to the same standards for review as set forth under Rule 3110.12. Where a member's remote inspection of an office or location identifies any "red flags," the member may need to impose additional supervisory procedures for that office or location or may need to provide for more frequent monitoring of that office or location, including potentially a subsequent on-site visit on an announced or unannounced basis.

(e) Documentation Requirement. A member must maintain and preserve a centralized record for each of the Pilot Years specified in this Remote Inspections Pilot Program that separately identifies: (1) all offices or locations that were inspected remotely; and (2) any offices or locations for which the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in paragraph (d) of this Supplementary Material. A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection, including whether an on-site inspection was conducted at such office.

(f) Firm Level Requirements

(1) Firm Level Ineligibility Criteria

A member shall not be eligible to conduct remote inspections of any of its offices or locations in accordance with this Supplementary Material if any time during the pilot period the member:

(A) is or becomes designated as Restricted Firm under Rule 4111;

(B) is or becomes designated as a Taping Firm under Rule 3170;

(C) receives a notice from FINRA pursuant to Rule 9557 regarding compliance with Rule 4110 (Capital Compliance), Rule 4120 (Regulatory Notification and Business Curtailment) or Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties);

(D) is or becomes suspended from membership by FINRA;

(E) based on the date in the Central Registration Depository (CRD), had its FINRA membership become effective within the prior 12 months; or

(F) is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c) (Internal Inspections).

(2) Firm Level Conditions

As part of the requirements in paragraph (b) to develop a reasonably designed risk-based approach to using remote inspections and to conduct and document a risk assessment for each office or location, the member must satisfy the following conditions:

(A) Recordkeeping System

The member must have a recordkeeping system:

(i) to make and keep current, and preserve records required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110;

(ii) such records are not physically or electronically maintained and preserved at the office or location subject to the remote inspection; and

(iii) the member has prompt access to such records; and

(B) Surveillance and Technology Tools

The member must determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each such remotely supervised office or location. These tools may include but are not limited to:

(i) firm-wide tools such as electronic recordkeeping systems; electronic surveillance of e-mail and correspondence; electronic trade blotters; regular activity-based sampling reviews; and tools for visual inspections;

(ii) tools specifically applied to such office or location based on the activities of associated persons, products offered, restrictions on the activity of the office or location (including holding out to customers and handling of customer funds or securities); and

(iii) system security tools such as secure network connections and effective cybersecurity protocols.

(g) Location Level Requirements

(1) Location Level Ineligibility Criteria

Subject to paragraph (f) of this Supplementary Material, a member's office or location shall not be eligible for a remote inspection in accordance with this Supplementary Material if at any time during the pilot period:

(A) one or more associated persons at such office or location is or becomes subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or a state regulatory agency;

(B) one or more associated persons at such office or location is or becomes statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a mandatory heightened supervisory plan under paragraph (g)(1)(A) of this Supplementary Material or otherwise as a condition to approval or permission for such association;

(C) the firm is or becomes subject to Rule 1017(a)(7) as a result of one or more associated persons at such office or location; or

(D) one or more associated persons at such office or location has an event in the prior three years that required a "yes" response to any item in Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4;

(E) one or more associated persons at such office or location is or becomes subject to a disciplinary action taken by the member that is or was reportable under Rule 4530(a)(2);

(F) one or more associated persons at such office or location is engaged in proprietary trading, including the incidental crossing of customer orders, or the direct supervision of such activities; or

(G) the office or location handles customer funds or securities.

(2) Location Level Conditions

As part of the requirement to develop a reasonably designed risk-based approach to using remote inspections, and the requirement to conduct and document a risk assessment for each office or location in accordance with paragraph (b) of this Supplementary Material, a specific office or location of the member must also satisfy the following conditions:

(A) electronic communications (e.g., e-mail) are made through the member's electronic system;

(B) the associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with Rule 3110; and

(C) no books or records of the member required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules and the member's own written supervisory procedures under Rule 3110 are physically or electronically maintained and preserved at such office or location.

(h) Data and Information Collection Requirement

(1) Data and Information. A member that elects to participate in the Remote Inspections Pilot Program shall collect the following data and information

and provide such data and information to FINRA, on a quarterly basis, and in the manner and format determined by FINRA. For items (A) through (F) below, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110. For purposes of this paragraph, the term "finding" means a discovery made during an inspection that led to a remedial action or was listed on the member's inspection report:

(A) number of locations with an inspection completed during each calendar quarter;

(B) number of locations in paragraph (h)(1)(A) that were inspected remotely;

(C) number of locations in paragraph (h)(1)(A) that were inspected on-site;

(D) number of locations in paragraph (h)(1)(C) that were inspected on-site because of a finding;

(E) number of locations in paragraph (h)(1)(B) where findings were identified, the number of those findings and a list of the most significant findings;

(F) number of locations in paragraph (h)(1)(C) where findings were identified, the number of those findings and a list of the most significant findings; and

(G) requirements of the written supervisory procedures for Remote Inspections in each of the four areas below. This information

should be provided with the first delivery of data made pursuant to this paragraph, and thereafter with the first delivery of such data made after any amendments to the written supervisory procedures for Remote

Inspections:

- (i) procedures for escalating significant findings;
- (ii) procedures for new hires;
- (iii) procedures for supervising brokers with a significant history of misconduct; and
- (iv) procedures related to outside business activities (OBAs) and doing business as (DBA) designations.

(2) Additional Data and Information for Pilot Year 1, if Less Than

Full Calendar Year. In addition to the information set forth in paragraph (h)(1) of this Supplementary Material, if Pilot Year 1 covers a period that is less than a full calendar year, a member that elects to participate the Remote Inspections Pilot Program shall collect the following data and information and provide such data and information to FINRA no later than December 31 of such first Pilot Year in the manner and format determined by FINRA. For the items referenced in paragraphs (h)(2)(A) through (C) below, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110:

- (A) the number of offices and locations with an inspection completed during the full calendar year of the first Pilot Year;

(B) the number of offices and locations in paragraph (h)(2)(A) that were inspected remotely during the full calendar year of the first Pilot Year; and

(C) the number of offices and locations in paragraph (h)(2)(A) that were inspected on-site during the full calendar year of the first Pilot Year.

(3) Additional Data and Information for Calendar Year 2019. In

addition to the information set forth in paragraphs (h)(1) and (h)(2) of this Supplementary Material, for calendar year 2019, a member that elects to participate in the Remote Inspections Pilot Program shall collect the following data and information and provide such data and information to FINRA no later than December 31 of Pilot Year 1 in the manner and format determined by FINRA. For the items referenced in paragraphs (h)(3)(A) and (B) below, a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations consistent with paragraphs (c)(1)(A), (B) and (C) under Rule 3110:

(A) the number of offices and locations with an inspection completed during calendar year 2019;

(B) the number of offices and locations referenced in paragraph (h)(3)(A) where findings were identified, the number of those findings and a list of the most significant findings.

(4) Written Policies and Procedures. A member shall establish, maintain and enforce written policies and procedures that are reasonably designed

to comply with the data and information collection, and transmission requirements of paragraph (h) of this Supplementary Material.

(i) Election to Participate in Remote Inspections Pilot Program. A member that elects to participate in the Remote Inspections Pilot Program for any Pilot Year shall, at least five calendar days before the beginning of such Pilot Year, provide FINRA an "opt-in notice" in the manner and format determined by FINRA. By providing such opt-in notice to FINRA, the member agrees to participate in the Remote Inspections Pilot Program for the duration of such Pilot Year and to comply with the requirements of Rule 3110.18. A member that provides an opt-in notice for a Pilot Year shall be automatically deemed to have elected and agreed to participate in the Remote Inspections Pilot Program for subsequent Pilot Years until the Remote Inspections Pilot Program expires. A member that elects to withdraw from subsequent Pilot Years (i.e., Pilot Year 2, Pilot Year 3, and Pilot Year 4, if applicable) shall, at least five calendar days before the end of the then current Pilot Year, provide FINRA with a "opt-out notice" in the manner and format determined by FINRA. FINRA may, in exceptional cases and where good cause is shown, waive the applicable timeframes for the required opt-in or opt-out notices.

(j) Failure to Satisfy Conditions. A member that fails to satisfy the conditions of Rule 3110.18, including the requirement to timely collect and submit the data and information to FINRA as set forth in paragraph (h) of this Supplementary Material, shall be ineligible to participate in the Remote Inspections Pilot Program and must conduct on-site inspections of each office and location on the required cycle in accordance with Rule 3110(c).

(k) Determination of Ineligibility. FINRA may make a determination in the public interest and for the protection of investors that a member is no longer eligible to participate in the Pilot Program if the member fails to comply with the requirements of Rule 3110.18. In such instances, FINRA will provide written notice to the member of such determination and the member would no longer be eligible to participate in the Pilot Program and must conduct on-site inspections of required offices and locations in accordance with Rule 3110(c).

(l) Definitions. For purposes of this Supplementary Material, the term "Pilot Year" shall mean the following:

(1) Pilot Year 1 is the period beginning on [insert effective date] and ending on December 31 of the same year;

(2) Pilot Year 2 means the calendar year period following Pilot Year 1, beginning on January 1 and ending on December 31;

(3) Pilot Year 3 means the calendar year period following Pilot Year 2, beginning on January 1 and ending on December 31; and

(4) If applicable, where Pilot Year 1 covers a period that is less than a full calendar year, then Pilot Year 4 means the period following Pilot Year 3, beginning on January 1 and ending on [insert date that is three years after effective date].

(m) Sunset of Rule 3110.17. If Rule 3110.17 has not already expired by its own terms, Rule 3110.17 will automatically sunset on [insert effective date].

.19 Reserved.

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