

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of \* 30

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

File No. \* SR 2023 - \* 007

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 * <input type="checkbox"/>	Amendment * <input checked="" 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"/>
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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) \*

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 \* 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 duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 08/01/2023

(Title \*)

By Kosha Dalal

Vice President and Associate General Counsel

(Name \*)

Kosha Dalal

Digitally signed by Kosha Dalal  
Date: 2023.08.01 16:29:41 -04'00'

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.

Required fields are shown with yellow backgrounds and astericks.

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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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**

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**

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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.

FINRA-2023-007 Partial A-1.docx  
FINRA-2023-007 Partial A-1 Exhibit 4.c  
FINRA-2023-007 Partial A-1 Exhibit 5.c

On April 14, 2023, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change, SR-FINRA-2023-007, to amend FINRA Rule 3110 (Supervision) to adopt new Supplementary Material .18 (Remote Inspections Pilot Program).<sup>1</sup> 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 Proposal is largely similar to File No. SR-FINRA-2022-021, which FINRA filed in July 2022 and amended in December 2022,<sup>2</sup> then withdrew in April 2023 to consider whether modifications and clarifications to that proposed rule change would be appropriate in response to comments.<sup>3</sup>

The Commission published the Proposal for public comment in the Federal Register on May 4, 2023 and received 13 comment letters in response.<sup>4</sup> On June 7, 2023, FINRA consented to an extension of the time period for SEC action on the proposed rule change to August 2, 2023.<sup>5</sup> In general, the majority of commenters express strong support for the overall intent of the Proposal, and three commenters are critical of the Proposal.<sup>6</sup> FINRA anticipates submitting by separate letter its response to comments on the proposed rule change. In light of such comments, FINRA is proposing to amend proposed Rule 3110.18 to:

- Add language highlighting that as part of the risk assessment and consistent with Rule 3110(a) (Supervisory System), firms must take into

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<sup>1</sup> See Securities Exchange Act Release No. 97398 (April 28, 2023), 88 FR 28620 (May 4, 2023) (Notice of Filing of File No. SR-FINRA-2023-007) (the “Proposal”).

<sup>2</sup> 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) and 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).

<sup>3</sup> See Withdrawal of File No. SR-FINRA-2022-021 (“2022 Remote Inspections Pilot Program Rule Filing”), <https://www.finra.org/rules-guidance/rule-filings/sr-finra-2022-021>.

<sup>4</sup> See Attachment A for the list of commenters.

<sup>5</sup> See Letter from Sarah Kwak, Associate General Counsel, FINRA, to Daniel Fisher, Division of Trading and Markets, SEC, dated June 7, 2023.

<sup>6</sup> See Anonymous, NASAA and PIABA.

consideration any red flags when determining whether to conduct a remote inspection of an office or location;

- Clarify that participating firms must provide FINRA with a list of “significant findings” rather than “most significant findings”;
- Adjust the proposed condition relating to 2019 data and information to account for impact of the record maintenance timeframe under Rule 3110(c)(2);
- Clarify the data and information requirements pertaining to a Pilot Year 1 that is less than a full calendar year; and
- Include several non-substantive, technical changes to improve readability.

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 Proposal, and Exhibit 5, which reflects all proposed changes to the current rule text, as amended by this Partial Amendment No. 1.

#### Risk Assessment (Proposed Rule 3110.18(b))

Proposed Rule 3110.18(b) would require a firm to conduct and document a risk assessment *prior to* electing a remote inspection for an office or location, rather than an on-site inspection, and sets forth a non-exhaustive list of factors a firm must consider. As described in more detail in FINRA’s Response to Comments, NASAA states that a firm should be required to conduct and document a risk assessment after identifying red flags, even if the firm already conducted and documented a risk assessment for that office or location. NASAA conveys that a firm should be required to fully consider any significant change in circumstances, particularly those that may warrant higher scrutiny of an office or location. In the alternative, NASAA recommends that FINRA revise proposed Rule 3110.18(b)(1) to “specify that firms must conduct a risk assessment for each location before each remote inspection of that location.”

FINRA believes that NASAA’s concern that firms fully consider changes in circumstances that may result in a “higher scrutiny of an office or location than previously thought necessary[,]” is embodied in Rule 3110. For example, firms have an obligation under Rule 3110(a) to *establish and maintain* (emphasis added) 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. Proposed Rule 3110.18(b)(2) would expressly require a firm to consider numerous factors in conducting a risk assessment, including specifically where there are red flags. In light of NASAA’s concern, FINRA is proposing to amend proposed Rule 3110.18(b)(2) to add the following language, “[m]oreover, consistent with Rule 3110(a),

the member's supervisory system must take into consideration any red flags when determining whether to conduct a remote inspection of an office or location.”<sup>7</sup>

Further, FINRA highlights that proposed Rule 3110.18(b)(2) references Rule 3110.12, which provides more detail about the standards of review associated with fulfilling Rule 3110(c) obligations. Rule 3110.12 states, in part, that “[t]he procedures established and reviews conducted must provide that the quality of supervision at remote locations is sufficient to ensure compliance with applicable securities laws and regulations and with FINRA rules. A member must be especially diligent in establishing procedures and conducting reasonable reviews with respect to a non-branch location where a registered representative engages in securities activities. Based on the factors outlined [in Rule 3110.12], members may need to impose reasonably designed supervisory procedures for certain locations or may need to provide for more frequent reviews of certain locations.” As stated in the Proposal, “[t]his 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.”<sup>8</sup>

#### Data and Information Collection Requirement (Proposed Rule 3110.18(h))

Proposed Rule 3110.18(h)(1) would require a firm to collect and produce to FINRA on a quarterly frequency and in a manner and format determined by FINRA, specified categories of data with separate counts for offices of supervisory jurisdiction (“OSJs”), supervisory branch offices, non-supervisory branch offices, and non-branch locations. These categories would include, among others, (1) the number of locations for which a remote inspection was conducted in the calendar quarter where findings were identified, the number of findings, and a list of the “most significant” findings and (2) the number of locations for which an on-site inspection was conducted in the calendar quarter where findings were identified, the number of findings, and a list of the most significant findings.

Proposed Rule 3110.18(h)(2) would also require a firm to collect and provide to FINRA similar data and information for the first year of the pilot program if it is less than a full calendar year: (1) the number of offices and locations with an inspection completed during the full calendar year of the first year of the pilot program; (2) the number of offices and locations in item (1) that were inspected remotely during the same timeframe; and (3) the number of offices and locations that were inspected on-site. This proposed

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<sup>7</sup> Proposed Rule 3110.18(c) (Written Supervisory Procedures) references Rule 3110(b) (Written Procedures). To align proposed Rule 3110.18(c) with the language in Rule 3110(b), FINRA is proposing a technical change to replace “adopt” with “establish, maintain, and enforce.”

<sup>8</sup> See Proposal, supra note 1, 88 FR 28620, 28634.

provision is intended to capture data and information about inspections that may occur in the time period preceding the effective date of the proposed pilot program if it does not start on January 1 of the calendar year.

Finally, proposed Rule 3110.18(h)(3) would require a firm to collect and provide to FINRA similar data and information for calendar year 2019: (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.

Based on the comments, FINRA is amending the Proposal as described below.

- *The Meaning of "Significant Findings" for Purposes of Data and Information Collection; all Findings*

As noted above, among the data participating firms must submit to FINRA on a quarterly basis pursuant to proposed Rule 3110.18(h) is the number of findings identified through a remote inspection and an on-site inspection and a list of the “most significant findings.” As stated in the Proposal, 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.”<sup>9</sup>

In response to comments that it may be challenging for firms to differentiate between “significant” findings and “most significant” findings and that the latter is too limiting,” FINRA is proposing to remove the “most” superlative so that the data that firms would be required to provide FINRA would be the “significant findings” in accordance with the description above. As stated in the Proposal, “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 what constitutes 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

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<sup>9</sup> See Proposal, supra note 1, 88 FR 28620, 28632 n.92.

inspections.”<sup>10</sup> NASAA also recommends that proposed Rule 3110.18(h) be revised to require firms to provide FINRA with information about “all findings.” FINRA declines to make this adjustment. FINRA continues to maintain that requiring firms to provide FINRA with 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.”<sup>11</sup>

- *Additional Data and Information for Calendar Year 2019*

As noted above, to provide FINRA with some baseline data and information about on-site inspections just prior to the pandemic, proposed Rule 3110.18(h)(3) would require a participating firm to collect and provide to FINRA specified calendar year 2019 data and information, including the number of OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations where findings were identified, the number of those findings and a list of the most significant findings.

CAI and FSI share their views on this proposed data requirement. While they do not dispute the value of obtaining baseline data, they express concerns about the availability of 2019 calendar year data in light of Rule 3110(c)(2), which specifies that firms maintain their inspection reports for a minimum of three years. Both commenters note that it could be possible that some firms may no longer have all the information specified in proposed Rule 3110.18(h)(3). FSI notes that the information specified under proposed Rule 3110.18(h)(3)(B) relating to findings would likely be found in inspection reports, which some firms may no longer maintain. CAI and FSI express concern that potentially incomplete 2019 calendar year data would preclude a firm from participating in the pilot program. These commenters recommend that proposed Rule 3110.18(h)(3) be adjusted to account for the records maintenance requirement in Rule 3110(c)(2) by instead imposing a “best efforts” standard for producing 2019 data.

In light of comments noting that not all firms will have maintained the 2019 data, in part because Rule 3110(c)(2) requires firms to maintain their inspection reports for a minimum of three years and the relevant data may be found in those reports, FINRA is proposing to amend Rule 3110.18(h)(3) to require that for calendar year 2019, a firm that elects to participate in the Remote Inspections Pilot Program would be required to act in good faith using best efforts to collect and provide the specified data and information to FINRA. As such, a firm that is unable to provide the data specified in proposed Rule 3110.18(h)(3) would not necessarily be precluded from participating in the pilot program. FINRA strongly encourages firms that plan to participate in the proposed program, if approved, to retain their 2019 calendar year data and information, as that information will enhance the value of the pilot for any future potential permanent rulemaking.

- *Additional Data and Information for Pilot Year 1, if Less Than Full Calendar Year*

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<sup>10</sup> See Proposal, supra note 1, 88 FR 28620, 28632.

<sup>11</sup> See Proposal, supra note 1, 88 FR 28620, 28632.

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. This proposed provision is intended to capture data and information about inspections that may occur in the time period preceding the effective date of the proposed pilot program if such effective date results in Pilot Year 1 being less than a full calendar year.

Currently, Rule 3110.17 (Temporary Relief to Allow Remote Inspections for Calendar Years 2020, 2021, 2022, and 2023) is set to expire on December 31, 2023, unless such temporary relief is further extended through a rule filing with the SEC. After that expiration date and before the start of the proposed pilot program, if approved, firms would no longer be able to fulfill their Rule 3110(c)(1) obligations remotely. For example, if the proposed pilot program, if approved, starts on July 1, firms would need to fulfill any inspection obligations under Rule 3110(c) occurring during the period January 1 (or any further extension of the temporary relief that may become effective) through June 30 with an on-site visit. Proposed Rule 3110.18(h)(2) would require a firm to provide FINRA specified data and information covering that period.

FINRA is proposing to adjust to language in proposed Rule 3110.18(h)(2) to clarify the data and information production requirements for this “gap period” to include: (1) the number of offices and locations with an inspection completed between January 1 of Pilot Year 1 and the day before the effective date of the Program; (2) the number of offices and locations in paragraph (h)(2)(A) that were inspected remotely between January 1 of Pilot Year 1 and the day before the effective date of the Program; and (3) the number of offices and locations in paragraph (h)(2)(A) that were inspected on-site between January 1 of Pilot Year 1 and the day before the effective date of the Program. In addition, to align with the data and information requirements under proposed Rule 3110.18(h)(1)(F) and proposed Rule 3110.18(h)(3)(B), as amended herein, FINRA is proposing to add a requirement for firms to provide FINRA with the number of offices and locations where findings were identified during a remote or on-site inspection, the number of those findings and a list of the significant findings.



**Attachment A: Alphabetical List of Commenters to File No. SR-FINRA-2023-007**

1. Anonymous (May 9, 2023)
2. Barbara Armeli, Charles Schwab & Co., Inc. & Lynn Konop, TD Ameritrade, Inc. (together, “Schwab”) (May 25, 2023);
3. David T. Bellaire, Financial Services Institute (“FSI”) (May 25, 2023)
4. Hugh Berkson, Public Investors Advocate Bar Association (“PIABA”) (May 24, 2023)
5. Bernard V. Canepa, Securities Industry and Financial Markets Association (“SIFMA”) (May 26, 2023)
6. Andrew Hartnett, North American Securities Administrators Association, Inc. (“NASAA”) (May 25, 2023)
7. Christopher A. Iacovella, American Securities Association (“ASA”) (May 25, 2023)
8. Clifford Kirsch & Eric Arnold, Eversheds Sutherland (US) LLP on behalf of the Committee of Annuity Insurers (“CAI”) (May 25, 2023)
9. Gail Merken, Janet Dyer & John McGinty, Fidelity Investments (“Fidelity”) (May 25, 2023)
10. Dee O’ Neill, Raymond James & Associates, Inc. (“Raymond James”) (May 23, 2023)
11. Mark Quinn, Cetera Financial Group (“Cetera”) (May 25, 2023)
12. Mark Seffinger, LPL Financial (“LPL”) (May 25, 2023)
13. Karol Sierra-Yanez, MML Investors Services, LLC (“MMLIS”) (May 24, 2023)

**EXHIBIT 4**

Proposed new language is underlined; proposed deletions are in brackets. 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) Risk Assessment**

(1) No Change

**(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"). Moreover, consistent with Rule 3110(a), the member's supervisory system must take into consideration any red flags when determining whether to conduct a remote inspection of an office or location.

**(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]establish, maintain, and enforce 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) No Change.

**(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 or location.

(f) No Change.

**(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) through (B) No Change.

(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) through (G) No Change.

(2) No Change.

**(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 the items referenced in paragraphs (h)(1)(A) through (F) [below] of this Supplementary Material, 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 offices and locations with an inspection completed during each calendar quarter;

(B) number of offices and locations in paragraph (h)(1)(A) that were inspected remotely;

(C) number of offices and locations in paragraph (h)(1)(A) that were inspected on-site;

(D) number of offices and locations in paragraph (h)(1)(C) that were inspected on-site because of a finding;

(E) number of offices and 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 offices and 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) No Change.

**(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 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 such first Pilot Year in the manner and format determined by FINRA. For the items referenced in paragraphs (h)(2)(A) through [(C)](E) [below]of this Supplementary Material, 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] between January 1 of Pilot Year 1 and the day before the effective date of the Remote Inspections Pilot Program;

(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] between January 1 of Pilot Year 1 and the day before the effective date of the Remote Inspections Pilot Program; [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] between January 1 of Pilot Year 1 and the day before the effective date of the Remote Inspections Pilot Program[.];

(D) the number of offices and locations in paragraph (h)(2)(B) where findings were identified, the number of those findings and a list of the significant findings; and

(E) the number of offices and locations in paragraph (h)(2)(C) where findings were identified, the number of those findings and a list of the significant findings.

**(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 act in good faith using best efforts to 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]of this Supplementary Material, 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; and

(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) through (m) No Change.

**.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.** 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"). Moreover, consistent with Rule 3110(a), the member's supervisory system must take into consideration any red flags when determining whether to conduct a remote inspection of an office or location.

**(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 establish, maintain, and enforce 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 or location.

**(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;

(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 the items referenced in paragraphs (h)(1)(A) through (F) of this Supplementary Material, 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 offices and locations with an inspection completed during each calendar quarter;

(B) number of offices and locations in paragraph (h)(1)(A) that were inspected remotely;

(C) number of offices and locations in paragraph (h)(1)(A) that were inspected on-site;

(D) number of offices and locations in paragraph (h)(1)(C) that were inspected on-site because of a finding;

(E) number of offices and locations in paragraph (h)(1)(B) where findings were identified, the number of those findings and a list of the significant findings;

(F) number of offices and locations in paragraph (h)(1)(C) where findings were identified, the number of those findings and a list of the 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 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 such first Pilot Year in the manner and format determined by FINRA. For the items referenced in paragraphs (h)(2)(A) through (E) of this Supplementary Material, 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 between January 1 of Pilot Year 1 and the day before the effective date of the Remote Inspections Pilot Program;

(B) the number of offices and locations in paragraph (h)(2)(A) that were inspected remotely between January 1 of Pilot Year 1 and the day before the effective date of the Remote Inspections Pilot Program;

(C) the number of offices and locations in paragraph (h)(2)(A) that were inspected on-site between January 1 of Pilot Year 1 and the day before the effective date of the Remote Inspections Pilot Program;

(D) the number of offices and locations in paragraph (h)(2)(B) where findings were identified, the number of those findings and a list of the significant findings; and

(E) the number of offices and locations in paragraph (h)(2)(C) where findings were identified, the number of those findings and a list of the significant findings.

**(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 act in good faith using best efforts to 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) of this Supplementary Material, 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; and

(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 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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