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Ms. Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

**Re: File No. SR-FINRA-2023-007 – 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).<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

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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).

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> On August 1, 2023, FINRA filed Partial Amendment No. 1, which proposed changes to the Proposal informed by the comments.<sup>6</sup> On August 2, 2023, the Commission instituted proceedings to determine whether to approve or disapprove the Proposal.<sup>7</sup>

This letter responds to the material issues raised by commenters, many of which view the Proposal as a step towards modernizing FINRA rules.<sup>8</sup> For example, MMLIS states that the Proposal is a “solid step forward in modernizing FINRA[] rules[.]” Fidelity expresses appreciation for FINRA’s “willingness to evaluate the longstanding in-person inspection requirements based on lessons learned during the COVID-19 pandemic, evolving technology and current and future workforce arrangements.” Cetera states that “[t]he objective is to modernize FINRA rules that most interested parties agree are out of date and no longer consistent with the way FINRA member firms conduct oversight and supervision of their securities business.” Several commenters further note the growing shift towards workplace flexibility is an important tool for attracting and retaining talent in the financial industry, particularly with respect to diversity and inclusion initiatives.<sup>9</sup>

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<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 Securities Exchange Act Release No. 98046 (August 2, 2023), 88 FR 53569 (August 8, 2023) (Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2023-007).

<sup>7</sup> See note 6, *supra*.

<sup>8</sup> See ASA, Cetera, Fidelity, FSI, MMLIS, Raymond James, Schwab and SIFMA.

<sup>9</sup> See FSI, MMLIS and Raymond James.

Three commenters—Anonymous, NASAA and PIABA—oppose the Proposal. Anonymous contends that the same standards being imposed upon member firms are not being applied to FINRA employees, and that the Proposal would encourage member firms to shift away from the broker-dealer industry to the investment advisory industry. PIABA and NASAA continue to express more fundamental concerns with the proposed pilot approach to assess the efficacy of remote inspections.

PIABA believes the Proposal runs counter to investor protection. Overall, PIABA’s concern relates to supervision generally, stating that the Proposal does not address the “significant harm done to investors by rogue brokers working without someone adequately supervising them.” PIABA states that the Proposal is a “fundamentally flawed idea” because it weakens the rules relating to the inspection of home offices, stating that an in-person audit would detect things that technology cannot such as building signage, office-sharing with other professionals or businesses, an advisor’s car and personal belongings, and assessing generally whether an advisor is living within the advisor’s means. PIABA points to several cases involving, for example, misconduct related to sales practices or supervision generally (e.g., registered person’s failure to disclose outside business activity to the firm, firm’s failure to use exception reports, firm’s failure to enforce written supervisory procedures), that occurred as early as 1989 that it believes supports why the Proposal should be disapproved. Finally, PIABA cites to several news articles for “the argument that the Pandemic-related need to allow increased use of remote inspections, and the resulting need to use technological tools to remotely supervise those activities, is no longer compelling as the number of people working remotely dwindles.”

NASAA, while acknowledging meaningful improvements in this Proposal from the 2022 Remote Inspections Pilot Program Rule Filing,<sup>10</sup> renews its call for the Commission to withhold approval of the Proposal and instead require FINRA to “conduct a fulsome examination sweep, produce a public report of its findings, and offer a proposal consistent with the evidence gathered.”<sup>11</sup> NASAA again states that the proposed voluntary, three-year

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<sup>10</sup> For example, NASAA generally supports the proposed firm level ineligibility criteria (proposed Rule 3110.18(f)(1) (Firm Level Ineligibility Criteria)); the firm level condition related to recordkeeping (proposed Rule 3110.18(f)(2)(A) (Recordkeeping System)); the proposed collection of data and information on a quarterly basis (proposed Rule 3110.18(h)); and the proposed collection of 2019 data and information (proposed Rule 3110.18(h)(3) (Additional Data and Information for Calendar Year 2019)).

<sup>11</sup> FINRA notes that NASAA, through its comment letter in response to this Proposal, reiterates and incorporates its three comment letters submitted in response to the 2022 Remote Inspections Pilot Program Rule Filing. See Letters from Melanie Senter Lubin, NASAA President and Maryland Securities Commissioner, to J. Matthew DeLesDernier, Assistant Secretary, SEC, dated August 23, 2022,

pilot program to assess remote inspections in the current environment is “not well supported” because it lacks meaningful data. NASAA also casts doubt about firms’ use of technology for supervision. Notwithstanding its fundamental opposition to the Proposal, NASAA recommends more prescriptive changes to proposed Rule 3110.18, as described below.

In light of the comments received in response to the Proposal, FINRA is proposing to amend the Proposal as set forth in Partial Amendment No. 1 to:

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

The following are FINRA’s responses to the material issues raised by commenters.<sup>12</sup>

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<https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20137299-307862.pdf>; Andrew Hartnett, NASAA President and Deputy Commissioner, Iowa Insurance Division, to Sherry R. Haywood, Assistant Secretary, SEC, dated December 7, 2022, <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20152479-320342.pdf>; and Andrew Hartnett, NASAA President and Deputy Commissioner, Iowa Insurance Division, to Sherry R. Haywood, Assistant Secretary, SEC, dated January 12, 2023), <https://www.sec.gov/comments/sr-finra-2022-021/srfinra2022021-20154758-323090.pdf>.

<sup>12</sup> FINRA notes that the comment letter from ASA for this Proposal is the same as the comment letter it submitted in response to FINRA’s proposed rule change relating to the adoption of proposed Rule 3110.19 (Residential Supervisory Location). As such, ASA’s comments related to proposed Rule 3110.19 are separately addressed

Risk Assessment (Proposed Rule 3110.18(b))

In addition to setting forth the terms that would exclude some member firms and their offices or locations from participating in the proposed pilot program, proposed Rule 3110.18 would also require a firm to conduct a risk assessment. Under proposed Rule 3110.18(b)(1), 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 office or location. Further, under proposed Rule 3110.18(b)(2), a firm would be required to consider, among other things, several enumerated factors including the volume and nature of customer complaints, the volume and nature of outside business activities, particularly investment-related, whether associated persons are subject to heightened supervision, and failures by associated persons to comply with the member's written supervisory procedures. In addition, the proposed provision 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."

Three commenters express their views on proposed Rule 3110.18(b).<sup>13</sup> Raymond James notes that a firm's use of a risk assessment would enable the firm to dedicate more resources to specialized inspections targeting higher risk areas. NASAA generally supports proposed Rule 3110.18(b), but believes that more guardrails are necessary. NASAA believes the Proposal should address when a risk assessment must be conducted and should require firms to provide to FINRA all risk assessments conducted after firms identify red flags during the program. FSI expresses concerns about how a firm's evaluation of the proposed factors in a risk assessment may be judged in hindsight.

- *Risk Assessment Conducted Before Electing a Remote Inspection or On-Site Inspection*

Proposed Rule 3110.18(b)(1) 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[.]" NASAA states that a firm should be required to conduct and

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as part of that proposed rule change. 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), <https://www.sec.gov/comments/sr-finra-2023-006/srfinra2023006.htm>.

<sup>13</sup> See FSI, NASAA and Raymond James.

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 expresses concern that a firm might rely on the previous risk assessment to conduct another remote inspection of such office or location even where red flags were identified, noting that “[s]ome firms may also choose not to conduct a follow-up in-person inspection if a remote inspection identifies any red flags.” NASAA conveys that “[i]t is important that firms be required to fully consider any significant change in circumstances, particularly where the changed circumstances may warrant higher scrutiny of an office or location than previously thought necessary.” 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.”

Proposed Rule 3110.18(b)(1) would require a firm to conduct a risk assessment *prior to* electing to conduct a remote inspection of an office or location and 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 addition, 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. 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 already addressed by Rule 3110. Nonetheless, 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>14</sup> FINRA believes that this additional language would make clear that a firm, consistent with Rule 3110(a), would need to consider red flags.

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

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<sup>14</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.”

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>15</sup>

- *Providing All Risk Assessments to FINRA After Identifying Red Flags*

NASAA recommends that during the pilot program, firms provide FINRA all the risk assessments they conduct after identifying red flags, articulating the view that this information production requirement would “maintain accountability by requiring firms to articulate a sound basis for these decisions based on analyses of the risks.” NASAA believes that having these risk assessments would be an important part of FINRA’s and the SEC’s ability to consider the efficacy of remote inspections.

While FINRA appreciates NASAA’s suggestion, FINRA declines to impose the requirement for firms to submit their risk assessments to FINRA. As stated more fully below, FINRA continues to believe that proposed Rule 3110.18 already requires submission of comprehensive data and information to FINRA during the proposed pilot program that is sufficient for FINRA to conduct its assessment. While proposed Rule 3110.18 would not require a firm to submit its risk assessments to FINRA on a regular frequency during the pilot program, FINRA notes that a firm would be required, if requested by FINRA staff, to produce such assessment during a FINRA examination (routine or cause).<sup>16</sup> FINRA believes this potential production requirement during a FINRA examination should provide sufficient accountability.

- *Hindsight Review of Factors Considered in a Firm’s Risk Assessment*

As noted above, FSI expresses concerns about how a firm’s evaluation of the proposed factors in a risk assessment may be judged in hindsight. FSI believes that the presence of one or more of the enumerated factors should not, per se, prevent a location from undergoing a remote inspection. By way of example, FSI states that a minor recordkeeping issue that arose five years ago may not be particularly relevant considering all the facts and circumstances. In addition, FSI questions the inclusion of the proposed factor pertaining to the presence of outside business activities, such as services offered

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<sup>15</sup> See Proposal, supra note 1, 88 FR 28620, 28634.

<sup>16</sup> See generally Rule 8210 (Provision of Information and Testimony and Inspection and Copying of Books).

through an affiliated registered investment adviser, because in FSI's view, this proposed factor does not seem consistent with the nature of other considerations in proposed Rule 3110.18(b)(2). Further, as a general matter, FSI states that FINRA should share its concerns about a firm's risk assessment through a "non-enforcement" manner that preserves the firm's ability to remain in the pilot program.

FINRA recognizes that the presence of one particular enumerated factor or others may not be dispositive as to whether an on-site or remote inspection of an office or location is appropriate, or whether a firm may conduct more frequent inspections than Rule 3110(c)(1) specifies. The presence of one or more factors should be reviewed in their totality by a firm in determining whether a remote inspection of an office or location is reasonable under the facts and circumstances, and should inform additional actions the firm may undertake as a result of such factors. FINRA emphasizes that the "reasonably designed" standard requires that the supervisory system, of which an inspection program is a part, "be a product of sound thinking and within the bounds of common sense, taking into consideration the factors that are unique to a member's business[.]"<sup>17</sup>

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

Under proposed Rule 3110.18(c), 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 securities laws and regulations, and with applicable FINRA rules. Such procedures must address, among other things, 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 proposed Rule 3110.18(b); the procedures specified in paragraphs (h)(1)(G) and (h)(4) of proposed Rule 3110.18;<sup>18</sup> 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 believes the principles-based requirements under Rule 3110 are insufficient guardrails and reiterates its recommendation for more prescriptive terms. NASAA states that a firm's written supervisory procedures should require more

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<sup>17</sup> See Notice to Members 99-45 (June 1999) ("Notice 99-45").

<sup>18</sup> 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) including data and information collection, and transmission.

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.”

FINRA declines to make this change and believes retaining the language in the written supervisory procedures provisions as proposed is appropriate. FINRA believes that proposed Rule 3110.18(c), which must be read with proposed Rule 3110.18(d)<sup>19</sup> and Rule 3110, would provide the appropriate guardrails that NASAA seeks while also remaining aligned with the core tenet of Rule 3110—that is, a member firm must have a “reasonably designed” supervisory system, including written supervisory procedures, to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.<sup>20</sup> FINRA emphasizes that the Proposal is not intended to change this tenet.

FINRA understands NASAA’s desire to add more specific details for a firm’s written supervisory procedures for remote inspections, but FINRA maintains that proposed Rule 3110.18(c), when read with proposed Rule 3110.18(d), in particular, reflects a balanced approach between dictating the content of a firm’s written supervisory procedures for remote inspections and maintaining a degree of flexibility that aligns with the tenor of Rule 3110’s principles-based view of written supervisory procedures.<sup>21</sup> Inherent in the principles of Rule 3110 is that what constitutes reasonably designed written supervisory procedures may change over time. To that end, FINRA notes that Rule 3120 (Supervisory Control System) and Rule 3130 (Annual Certification of Compliance and Supervisory Processes) require changes to a firm’s policies and procedures as dictated, for example, as a result of a firm testing and verifying its supervisory procedures, or due to regulatory

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<sup>19</sup> See generally proposed Rule 3110.18(d) (Effective Supervisory System).

<sup>20</sup> See generally Rule 3110(a) (Supervisory System) and Rule 3110(b) (Written Procedures).

<sup>21</sup> See Notice 99-45 (stating, among other things, that “[w]ritten supervisory procedures are not static documents that can be used for an indefinite period of time without modification. A firm’s existing supervisory system may become outdated or ineffective as a result of changes in the firm’s business lines, products, practices, or new or amended securities laws.”). See also Rule 3110(b)(7) (Maintenance of Written Supervisory Procedures).

changes or other events. As stated in the Proposal, FINRA expects a firm to consider Rule 3110.18 as part of its Rule 3130 annual certification process.<sup>22</sup>

- *Inspections as Part of a Reasonably Designed Supervisory System*

NASAA speculates that the proposed voluntary, three-year remote inspections pilot program could result in firms failing to detect investor harm. NASAA expresses concern that if “lax remote inspection practices become the norm, it will be difficult to bring robust supervision practices back up to an acceptable level, regardless of what the data ultimately suggest[.]” and “[a]t the end of the pilot program, it is likely that some member firms will have modified their business models to rely largely, if not solely, on remote inspections.” PIABA continues to argue that “there are some things that technology cannot detect, but would be found with little difficulty through an in-person audit.”<sup>23</sup>

FINRA reaffirms that the Proposal is not intended to signal that a firm may rely solely on remote inspections to fulfill its Rule 3110(c) obligations, but to permit firms to supplement their existing inspection programs with the option to conduct inspections remotely at office or locations where such remote inspections satisfy the proposed conditions in the rule and are consistent with a reasonably designed supervisory system. FINRA emphasizes that an inspection conducted on the prescribed schedule set forth in Rule 3110(c)(1) 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.<sup>24</sup> 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 in the Proposal. 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 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

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<sup>22</sup> See Proposal, supra note 1, 88 FR 28620, 28628.

<sup>23</sup> See PIABA (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).

<sup>24</sup> See generally Notice to Members 98-38 (May 1998).

that may provide a path towards modernizing Rule 3110(c). As articulated in prior guidance, firms should continuously monitor their offices and locations with respect to “changes in the overall business, products, people and practices” as part of an effective risk assessment process for inspections.<sup>25</sup>

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

Proposed Rule 3110.18(f)(2)(B) would require a participating firm to 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 further provide a non-exhaustive list of surveillance and technology tools that might be appropriate to supervise the types of risks presented by each such remotely supervised office or location. FINRA believes that the failure to have adequate surveillance and technology tools would raise questions about the reasonableness of remote inspections. While NASAA expresses general support for the proposed provision, it renews its recommendation to amend proposed Rule 3110.18(f)(2)(B). NASAA recommends that the language in proposed Rule 3110.18(f)(2)(B)—“[t]hese tools may include but are not limited to,”— be revised to make the enumerated tools mandatory so that they are “standard features” of all risk assessments and remote inspections. Referring to the 2022 Remote Inspections Pilot Program Rule Filing, NASAA notes the technologies several commenters articulated in response to that proposal to effectively surveil and conduct remote inspections (e.g., cloud account to upload documents to review, smart phones, video conferencing services, and publicly available resources).<sup>26</sup> For this reason, NASAA believes that “affirmatively requiring them would not substantially increase regulatory or compliance burdens.”

FINRA is retaining the language in proposed Rule 3110.18(f)(2)(B), as proposed. Proposed Rule 3110.18(f)(2)(B) states that a firm *must* determine that its surveillance and technology tools are appropriate to supervise the types of risks presented by each office or location, and describes a technology baseline for remote inspections that *may* include, but are not limited to, firm-wide tools such as electronic recordkeeping systems, surveillance or e-mail and correspondence, trade blotters, and tools for visual inspections.<sup>27</sup> This proposed non-exhaustive list is to account for the ongoing advances in technologies. Moreover,

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<sup>25</sup> See Regulatory Notice 11-54 (November 2011).

<sup>26</sup> See Proposal, Exhibit 2c.

<sup>27</sup> NASAA specifically mentions “videoconferencing technology, and particularly portable cameras” as tools that would be useful for an inspection. FINRA notes that proposed Rule 3110.18(f)(2)(B) attributes a general descriptor for such technology as “tools for visual inspections.”

FINRA recognizes that the use of specific tools for remote inspections may vary among firms depending upon their business activities, size and structure and, therefore, believes that “may” is appropriate in this case. FINRA notes that a firm’s use of only one enumerated technology tool may not necessarily satisfy the condition. A firm would need to assess the technology tools, collectively, that are applied to an 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 the system security tools such as secure network connections and effective cybersecurity protocols to determine if they are appropriate to supervise the risk presented by that office or location. FINRA further 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.

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

Proposed Rule 3110.18(g)(1) lists several location level ineligibility criteria. Among them is proposed Rule 3110.18(g)(1)(D) which would make a location ineligible for remote inspections if the associated person at the office or location provides “yes” responses to specified disclosure questions on Form U4 (Uniform Application for Securities Industry Registration or Transfer) pertaining to criminal convictions and adjudicated (i.e., “found”) regulatory actions.<sup>28</sup> As noted above, PIABA opposes the Proposal out of concern for its impact on supervision generally. PIABA states that proposed Rule 3110.18(g)(1)(D) would still allow brokers who have a “substantial number” of customer complaints, and have other disclosures relating to regulatory investigations, termination, and “significant” judgments or liens to participate in the proposed voluntary, three-year remote inspection pilot program. In addition, PIABA states that a broker who has those other disclosures outlined above “would all be allowed to participate in this pilot program” and thus, these problematic brokers would be subject to less oversight or scrutiny.

FINRA disagrees with PIABA’s comment and declines to change the proposed provision. Proposed Rule 3110.18(g)(1)(D), and all the other location level criteria, are based on clear, objective factors. In addition to these express ineligibility criteria, proposed Rule 3110.18 would subject offices and locations to specified conditions, and require a firm to conduct a risk assessment that must reflect the firm’s consideration of a non-exhaustive list of factors, including the volume and nature of customer complaints, and whether the associated person is subject to heightened supervision. Moreover, proposed Rule 3110.18 would account for a firm’s consideration of higher risk activities occurring at

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<sup>28</sup> See Form U4’s Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), and Questions 14C, 14D, and 14E.

an office or location, higher risk associated persons that are assigned to an office or location, or where there are indicators of irregularities or misconduct (i.e., “red flags”) as part of the risk assessment.<sup>29</sup> While FINRA declines to change proposed Rule 3110.18(g)(1) to expressly include the other disclosures PIABA mentions above, FINRA agrees that the presence of such disclosures on Form U4 would be a factor for a firm to consider as part of the risk assessment. Further, proposed Rule 3110.18 would require a firm to establish, maintain, and enforce written supervisory procedures for remote inspections and have an effective supervisory system.<sup>30</sup> FINRA believes that the objective ineligibility criteria, in addition to the other rigorous conditions and requirements articulated throughout proposed Rule 3110.18 in its entirety, provide the appropriate safeguards related to whether a particular office or location should be eligible to undergo a remote inspection.

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

Proposed Rule 3110.18(h)(1) would require a firm to collect and provide 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 period between January 1 of Pilot Year 1 and the day before the effective date of the Remote Inspections Pilot Program: (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 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

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<sup>29</sup> See proposed Rule 3110.18(b).

<sup>30</sup> See proposed Rule 3110.18(c) and proposed Rule 3110.18(d).

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.

Five commenters share their views on proposed Rule 3110.18(h) pertaining to the frequency of production, the meaning of “most significant” findings, and the production of data and information for calendar year 2019.<sup>31</sup>

- *Quarterly Frequency*

Two commenters express concern with the production of data and information to FINRA on a quarterly basis.<sup>32</sup> ASA and LPL express concern about the quarterly production frequency. ASA states because the data and information requirement is very detailed, imposing a quarterly frequency would be onerous for firms, particularly for smaller, middle market and regional firms. ASA suggests that rather than requesting data relating to both remote and on-site inspections, FINRA should instead require firms to provide FINRA the findings from remote inspections, which ASA believes would “satisfy any concerns around this issue.” LPL states that a quarterly reporting requirement will require firms to aggregate and report inspection results very quickly, explaining that for large firms like LPL, the proposed quarterly frequency will create additional compliance costs just to report the data. LPL suggests a biannual frequency to allow time for firms to compile and report the data.

Proposed Rule 3110.18(h)(1)(A) would seek to collect data about inspections *completed* in a calendar quarter. For example, if an inspection started in March and it was completed in July, the data about that inspection would belong to the third calendar quarter counts. FINRA is retaining the quarterly frequency and the data requirements related to both on-site and remote inspections because FINRA believes that the cadence and amount of comprehensive data are appropriate and necessary for FINRA to effectively study trends and firms’ experiences with their remote inspection programs in a timely manner. FINRA acknowledges the efforts that some firms may need to undertake to create new processes to conform to the proposed data and information requirements. FINRA appreciates the comments and is exploring ways for firms to provide this information to FINRA in a more efficient and timely manner.<sup>33</sup>

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<sup>31</sup> See ASA, CAI, FSI, LPL and NASAA.

<sup>32</sup> See ASA and LPL.

<sup>33</sup> As part of this development process, FINRA is assessing the timing of data and information submission. For example, FINRA is considering aligning the

- *The Meaning of “Significant Findings” for Purposes of Data and Information Collection; “All Findings”*

As noted above, among the data participating firms must provide 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>34</sup>

In response to comments that, without clear parameters, 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 inspections.”<sup>35</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

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Proposal’s quarterly data and information production requirements with the methodology that exists in other FINRA rules that also have quarterly reporting obligations.

<sup>34</sup> See Proposal, supra note 1, 88 FR 28620, 28632 n.92.

<sup>35</sup> See Proposal, supra note 1, 88 FR 28620, 28632.

it would be challenging to discern key trends in a meaningful way.”<sup>36</sup> Moreover, FINRA notes that this information may be procured during a FINRA examination, if appropriate.

- *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.<sup>37</sup>

CAI and FSI share a common view with regard to 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, 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.

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<sup>36</sup> See supra, note 35.

<sup>37</sup> See supra, note 35.

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

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. As stated above, 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 it does not start on January 1 of the 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, a firm 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 the language in proposed Rule 3110.18(h)(2) to clarify that the data and information production requirements for this “gap period” 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;<sup>38</sup> 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)(E) and (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.

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<sup>38</sup> If Rule 3110.17 is extended and is in effect during the period before the effective date of proposed Rule 3110.18, if approved, proposed Rule 3110.18(h)(2)(B) would require a firm to provide FINRA with the number of offices and locations that were inspected remotely under Rule 3110.17.

### Other Comments

- *Shift to Investment Advisory Industry*

As noted above, Anonymous contends that the same standards being imposed upon member firms are not being applied to FINRA employees, and that the Proposal would encourage member firms to shift away from the broker-dealer industry to the investment advisory industry. FINRA believes the comment is beyond the scope of this Proposal.

- *Review of Electronic Correspondence and Communications*

PIABA raises concerns with risk-based review of electronic correspondence and 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. 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."<sup>39</sup> 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.<sup>40</sup>

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<sup>39</sup> See Notice 07-59.

<sup>40</sup> See Notice 07-59.

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August 29, 2023

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- *The Inspection Requirement*

Raymond James requests that locations at which permissively registered persons, 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. While FINRA acknowledges the comment raised in this area, FINRA believes that it would be more appropriate to consider this view as part of future rulemaking.

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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) 728-8471, email: Sarah.Kwak@finra.org.

Best regards,

/s/ Sarah Kwak

Sarah Kwak  
Associate General Counsel  
Office of General Counsel

**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)