



**VIA ELECTRONIC MAIL**

February 11, 2021

Jennifer Piorko Mitchell  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 20-42 - FINRA Seeks Comment on Lessons From the COVID-19 Pandemic (Notice)

Dear Ms. Mitchell:

On December 16, 2019, the Financial Industry Regulatory Authority, Inc. (FINRA) published the Notice requesting feedback on lessons learned from stakeholders' experiences during the pandemic, including the impact of changes made to FINRA member firms' operations and business models, and the effectiveness of business continuity planning.<sup>1</sup> The Notice also requested comment on whether FINRA should consider changes to its rules, operations or administrative processes to address lessons learned during the pandemic or to address anticipated long-term impacts of the pandemic on FINRA member firms and investors.

Since the onset of the pandemic, FINRA has provided guidance and temporary regulatory relief by way of FINRA communications, frequently asked questions and temporary rule amendments.<sup>2</sup> In addition, FSI members have adapted their business operations to the unexpected and extraordinary circumstances brought on by the COVID-19 pandemic. FSI commends FINRA for its efforts, and appreciates the opportunity to provide feedback on behalf of FSI members.

**Background on FSI Members**

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are more than 160,000 independent financial advisors, which account for approximately 52.7 percent of all producing registered representatives.<sup>3</sup> These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).<sup>4</sup>

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<sup>1</sup> FINRA Regulatory Notice 20-42 (Dec. 16, 2020), <https://www.finra.org/sites/default/files/2020-12/Regulatory-Notice-20-42.pdf>.

<sup>2</sup> FINRA, COVID-19/Coronavirus, <https://www.finra.org/rules-guidance/key-topics/covid-19>.

<sup>3</sup> Cerulli Associates, Advisor Headcount 2016, on file with author.

<sup>4</sup> The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a dually registered representative of a broker-dealer and an investment adviser representative of a registered investment

FSI's IBD members provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI members and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate \$35.7 billion in economic activity. This activity, in turn, supports 408,743 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly \$7.2 billion annually to federal, state, and local government taxes.<sup>5</sup>

In light of the COVID-19 pandemic, FSI members have made major adjustments to their business operations. FSI members have been focused on protecting the health of their employees, clients and the general public, as an attempt to mitigate the spread of the virus. FSI members and their retail investors are practicing social distancing and working remotely in compliance with state and local shelter-in-place mandates and healthcare guidelines. For example, financial professionals have ceased most in-person meetings with retail investors, and many business and client meetings are taking place via telephone or video.

For the most part, FSI members are operating under remote work plans during a period of uncertainty in communities across the country and in the financial markets, while their financial advisors are frequently engaged in life-defining discussions with clients about their families, careers, businesses, and retirement savings. Firms are also dedicating significant training and other support to assist their financial advisors in maintaining relationships with clients through virtual means.

Despite remote work and other shelter-in-place restrictions, FSI members have continued to take the steps necessary to comply with federal securities laws and FINRA rules. FSI members are appreciative of the guidance provided by the SEC and FINRA during this difficult time. We offer the following comments based on the Notice and our discussions with members.

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adviser firm. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

<sup>5</sup> Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2020).

## Discussion

### I. FINRA Should Provide Permanent Relief for Remote Inspections Subject to Certain Conditions.

FINRA Rule 3110 requires each FINRA member firm to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. More specifically, Rule 3110(c) requires each firm to review, at least annually (on a calendar-year basis), the businesses in which it engages, in a way that is reasonably designed to assist the firm in detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations, and with applicable FINRA rules. The rule requires that a firm review the activities of each office and inspect each office on a specified cycle depending on the office classification. Although not explicitly stated in the rule, the SEC and FINRA have interpreted this provision to require that inspections take place on-site, irrespective of the type of office.<sup>6</sup>

However, early in the pandemic, FINRA acknowledged that many firms had migrated from “on-site inspections and, instead, created and implemented a temporary, fully remote inspection plan . . .”<sup>7</sup> Then, in November 2020, FINRA adopted temporary Supplementary Material .17 under FINRA Rule 3110 to provide firms the option, provided that the firm satisfies certain requirements under the proposed supplementary material, to complete remotely their calendar year 2020 and 2021 inspection obligations without an on-site visit to the office or location. Thus far, FSI members have had positive experiences with remote inspections, and have found remote inspections to be as efficient as on-site inspections. For example, FSI members are able to closely monitor the use of video conferences and other applications for compliance with federal securities laws and FINRA rules. Overall, FSI members have found that remote inspections still promote FINRA’s goal of investor protection. This is especially true given advancements and the widespread use of technology, which allows FSI members to easily conduct inspections using video conferencing, electronic document review and other available tools.

Thus far, FSI members have found remote inspections equally effective as on-site inspections at monitoring and detecting activities that potentially require redress, including review for outside business activities (OBAs). In fact, OBAs are often discovered and monitored through automated processes, such as reviewing an associated person’s bank records, emails, and through targeted Internet searches. When additional information is required from an associated person about any particular OBA, many FSI members have digital tools at their disposal to assist with obtaining necessary information from an associated person.

FSI members believe that, going forward, FINRA Rule 3110(c), and related guidance, should provide FINRA member firms with the flexibility to make the determination on a tailored and targeted basis of whether and when an inspection is “on-site” or “remote.” Accordingly, FSI recommends that FINRA permanently maintain its temporary position regarding on-site inspections. Specifically, FINRA member firms should be permitted to amend or supplement their

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<sup>6</sup> See Branch Office Inspections: FINRA and the SEC Issue Joint Guidance on Effective Policies and Procedures for Broker-Dealer Branch Inspections, FINRA Reg. Notice 11-54 (Nov. 2011) (stating “[a] broker-dealer must conduct on-site inspections of each of its office locations . . . at least annually” (emphasis added)).

<sup>7</sup> FINRA Regulatory Notice 20-16 (May 28, 2020).

written supervisory procedures to provide for remote inspections in compliance with Rule 3110.<sup>8</sup> In addition, a FINRA member firm's use of a remote inspection of an office or location should be held to the same standards for review as set forth under Rule 3110.12, and any indicators of irregularities or misconduct identified should necessitate additional supervisory procedures for that office or location or more frequent monitoring of that office or location. Last, a member who elects to use a remote inspection of an office or location should be required to maintain and preserve a centralized record that separately identifies: (1) all offices or locations that had inspections that were conducted remotely; (2) any offices or locations for which the member determined to impose additional supervisory procedures or more frequent monitoring; and (3) any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection.

## **II. FINRA Should Consider Amending the Definition of Branch Office and Office of Supervisory Jurisdiction (OSJ) to Account for the Increase in the Use of Remote Offices and Alternative Work Arrangements.**

FSI members have indicated an interest in continuing to allow use of remote offices or alternative work arrangements by some personnel after the pandemic. We urge FINRA to reconsider the branch office definition to account for an increase in use of remote offices and alternative work arrangements.

FINRA Rule 3110 defines the term "branch office" for purposes of the rule. However, as adopted, the rule includes a list of locations that are excluded from the definition. The practical implications of the exclusions in the definition mean that FINRA members would need to first determine whether it qualifies for an exclusion, before determining whether it falls within the definition of "branch office".

FSI believes that FINRA members would benefit from a simplified definition of branch office, and one that takes into consideration the realities of remote work. In addition, we recommend that FINRA put forth several factors that may be considered by a firm when determining whether remote inspections are suitable for a particular office. Such factors may include the firm's use of technology and systems that support remote inspections, the existence of Form U4-reportable events for any associated person working from a particular office, and the length of time that an associated person working from a particular office has been associated with a FINRA member firm. In addition, there should be some added flexibility for those offices at which neither customer funds nor securities are handled, or at which no books or records are maintained. Going forward, FINRA should permit its member firms to develop a risk-based process that allows inspections to be conducted remotely using existing technology (e.g., via video conference, use of electronic document systems for email, and gifts/entertainment blotter reviews). In particular, on-site inspections of a mutual fund or variable annuity wholesaler's home office would result in significant costs to a FINRA member firm, but an on-site inspection would not add any meaningful value to the inspection.

In addition, the branch office definition excludes "[a]ny location that is used primarily to engage in non-securities activities and from which the associated person(s) effects no more than 25 securities transactions in any one calendar year; provided that any retail communication

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<sup>8</sup> See, e.g., FINRA Rule 3110.17 (Temporary Relief to Allow Remote Inspections for Calendar Year 2020 and Calendar Year 2021).

identifying such location also sets forth the address and telephone number of the location from which the associated person(s) conducting business at the non-branch locations are directly supervised.”<sup>9</sup> This exclusion appears to be based on an assumption that a registered person is only present in one location; however, the past twelve months have demonstrated that a registered person may be present at a home office, business office, or move between both home and business offices. It may be practical for a registered person to use both home and business offices, and even if business offices are permitted to reopen, registered persons may still work from their home offices from time to time.

The designation of home offices and other remote work locations as branch office locations would place an undue burden on FINRA member firms, and inhibit any firm’s ability to use its supervisory resources in a way that is most beneficial for investor protection. Therefore, FSI recommends providing flexibility with respect to the number of transactions that may be facilitated through a “non-branch office,” given the current state of remote work and the likelihood that such alternative work arrangements will become commonplace. We urge FINRA to consider, for registered persons who are required or elect to work remotely, an increase in the number of transactions that may be facilitated through remote offices or locations without falling within the branch office definition. Alternatively, a more holistic revision of the branch office definition to one that is principles-based and reflects the ongoing shift to a more flexible, decentralized work location structure could address this issue as well.

We believe that similar considerations support revisiting the definition of “Office of Supervisory Jurisdiction”. FINRA Rule 3110(f)(1) defines an “Office of Supervisory Jurisdiction” as any office of a member at which any one or more of the following functions take place: (1) order execution or market making; (2) structuring of public offerings or private placements; (3) maintaining custody of customers’ funds or securities; (4) final acceptance (approval) of new accounts on behalf of the member; (5) review and endorsement of customer orders; (6) final approval of retail communications for use by persons associated with the member (except for an office that solely conducts final approval of research reports); or (7) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member. FSI members urge FINRA to continue to allow use of remote offices or alternative work arrangements by some personnel after the pandemic. Accordingly, for similar reasons as noted above with respect to the branch office definition, FSI recommends that FINRA amend the OSJ definition to account for the growing capability of persons to conduct activity in a home office only, or at both home office and business office locations. The definition should be modernized to capture the simple reality that today it is not realistic or helpful to characterize activity as occurring in a single location.

### **III. Accounting for Increases in OSJ and Branch Office Location – Continuing Membership Application (CMA) Implications.**

FSI requests that FINRA clarify and streamline the process for new branch office and OSJ locations through continuing member applications pursuant to FINRA Rule 1017. Currently, FINRA Rule 1017 requires a member firm to file an application for approval for any material change in its business operations. However, IM-1011-1 provides a safe harbor that will not require a member to submit a Rule 1017 application to obtain FINRA’s approval for certain types of business expansions. However, the safe harbor provided by IM-1011-1 only permits an eligible

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<sup>9</sup> FINRA Rule 3110(f)(2)(A)(v).

firm to minimally increase its number of registered or unregistered offices without triggering a 1017 application. Therefore, FSI urges FINRA to consider amendments to IM-1011-1 to provide relief to firms that may undergo material changes in business operations as a result of alternative work arrangements that may continue well after the pandemic comes to an end. Such amendments should include expanding eligibility without consideration of disciplinary history, providing one time exceptions to any restrictions in membership agreements, and increasing the number of offices that may be added pursuant to the safe harbor. Without this relief, the filing and approval process for Rule 1017 applications will create a regulatory hurdle too high for most FINRA member firms and many associated persons will be unable to continue work from remote offices.

#### **IV. FINRA Does Not Need to Amend Rule 4370 in Connection with Business Continuity Plans (BCPs).**

Pursuant to FINRA Rule 4370, FINRA requires firms to create and maintain written business continuity plans (BCPs) relating to an emergency or significant business disruption. As noted above, FSI members have not experienced notable challenges or issues regarding the implementation of their BCPs. Prior to the pandemic, many FSI members had developed BCPs and intended on testing their plans. However, due to the pandemic, many firms were required to implement their plans without completion of testing. FSI believes that the success of remote work during the pandemic has allowed firms to demonstrate their preparedness for emergencies and significant business disruptions. Based on members' experiences, FSI does not see the need for any amendments to Rule 4370.

#### **V. FINRA Continues to Make Great Strides Toward Leveraging Technology in Support of its Mission.**

In September 2020, FINRA's Board of Governors approved the filing with the SEC of proposed amendments to FINRA Rule 1010 (Form U4 Filing Requirements) to permit firms to obtain an electronic signature on the Uniform Application for Securities Industry Registration or Transfer (Form U4).<sup>10</sup> FSI commends FINRA on taking steps toward allowing electronic signatures on Form U4. FSI believes that this is a useful and appropriate step in light of current alternative work arrangements, and the availability and use of technology to support electronic signatures. Moreover, FSI commends FINRA for removing the last manual signature requirement from the FINRA rulebook. FSI looks forward to FINRA moving forward with the proposed rule.

In addition, FSI would like to commend FINRA for considering retaining and expanding online delivery of qualification exams after the pandemic. FINRA and NASAA have successfully delivered online testing for candidates for certain remote examinations. FSI members have found online testing services to be beneficial, and believe that FINRA and NASAA should continue to invest in online testing and seek to improve the online testing experience. Further, FSI encourages FINRA to expand the type of exams offered through online testing services (e.g., Series 24 exams).

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<sup>10</sup> Report from FINRA Board of Governors Meeting – September 2020.

## Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with FINRA on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 393-0022.

Respectfully submitted,

A handwritten signature in blue ink that reads "Robin Traxel". The signature is written in a cursive style with a long horizontal line extending to the right.

Vice President, Regulatory Affairs & Associate General Counsel