



Via E-mail: pubcom@finra.org

February 16, 2021

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

Re: **FINRA Regulatory Notice 20-42**

Dear Ms. Mitchell:

Please allow this to serve as comments from Cetera Financial Group, Inc. (“Cetera”) with regard to FINRA Regulatory Notice 20-42. Cetera is the corporate parent of a group of five FINRA member firms with more than 7,500 affiliated Financial Professionals. Our broker-dealers collectively serve more than 1 million retail investors, the large majority of whom are individuals, families, and small businesses.

We understand that the COVID-19 pandemic and the public health crisis that it created are the primary catalysts for publication of Notice 20-42 and the retrospective review of certain FINRA rules. The pandemic has focused attention on logistical and operational issues experienced by businesses of all types, and we commend FINRA for revisiting its rules in light of that. We believe this offers an opportunity to consider the impact of large-scale incidents such as pandemics that may disrupt business operations, but also to review the many significant changes that have taken place in the securities industry and at FINRA member firms over the past 20 years. Despite everyone’s best intentions, regulations often do not keep pace with changes in society and how business is conducted. While COVID-19 may have been the impetus for much of this retrospective rule review, there are other good reasons for FINRA to consider changes to its’ rules at this time.

Our comments will focus on several elements set out in Notice 20-42. They include the general topic of remote work arrangements and how they may impact the operations of FINRA members, administration of qualification examinations for registered individuals, and engagement between member firms and the FINRA organization as a whole.

I. Remote offices, alternative work arrangements, and remote inspections

Notice 20-42 notes that the COVID-19 pandemic has forced many businesses to operate with all or virtually all of their employees working outside of their usual office environments. The trend toward remote work has been underway for several years, but the pandemic forced many businesses to make immediate adjustments. For the most part, firms have functioned remarkably well, at least in the securities industry. We are not aware of any significant interruptions to the business of FINRA members, and most importantly, customers do not appear to have been negatively impacted in any material way.

While the changes brought about by the pandemic were certainly not welcome, they did establish that most FINRA member firms can operate effectively with virtually all of their employees at remote locations. We are certain that the COVID-19 pandemic will end and that business will return to something like what we considered normal, but we also believe that many businesses will never revert to their previous model in which substantially all of their employees perform their work functions from central locations. Allowing employees to operate remotely has a number of benefits for both businesses and employees. It expands the pool of talent available to firms by allowing them to have employees in multiple physical locations, and can increase productivity for employees by allowing them to avoid commuting to work. There is significant evidence that the majority of employees prefer having the flexibility to work remotely, and many businesses see the opportunity to lower their cost of operations by reducing the amount of office space that they occupy.¹ Many large employers have declared that their staff will have the ability to work remotely even after the pandemic ends and it is safe to return to their offices.² The more important factor in all of this is that it can be accomplished without negative impacts on FINRA's primary mission of investor protection. Modern technology has created an environment in which many tasks or functions that previously required physical presence can be done effectively from a distance. For example, most FINRA members perform review and supervision of correspondence and transaction activity on a remote basis through the use of electronic systems. These functions do not require physical presence and can be performed from virtually any location at any time. This was not logistically feasible at the time when many of FINRA's rules were enacted.

With all of the above in mind, we offer the following specific comments:

1. Definition of "Branch" offices and Offices of Supervisory Jurisdiction

FINRA Rule 3110(f) sets forth definitions for branch offices and Offices of Supervisory Jurisdiction ("OSJ") by listing a series of functions. If a function is performed in a

¹ <https://www.forbes.com/sites/carolinecastrillon/2021/12/27/this-is-the-future-of-remote-work-in-2021/?sh=462c70811e1d>

² <https://www.nytimes.com/2020/05/21/technology/facebook-remote-work-coronavirus.html#:~:text=Facebook%20will%20begin%20by%20allowing,they%20have%20positive%20performance%20reviews.>

location, it is deemed a branch or an OSJ, with all of the attendant registration, identification, inspection and other requirements. We suggest the following amendments to the current regime:

- a. In general, only physical locations that are held out to the public as offices or where required books and records are physically maintained should be included in the definition of either branch offices or OSJs. In the current era, employees and associated persons of FINRA members can execute transactions and perform supervisory functions such as review and approval of new accounts, execution and recording of transactions, and review of correspondence from virtually anywhere in the world. Records of all activity are maintained electronically in one or more physical locations. Defining branch offices to include the locations in which employees look at computer monitors is out of touch with how business operates.
- b. Rule 3110(f)(1)(G) deems any location an OSJ if it houses an individual who is responsible for supervision of other associated persons at one or more other branch locations. It has become increasingly likely that supervisory personnel for FINRA members will work from their homes or other non-office locations for extended periods, and perhaps permanently. The physical location of a supervisor should not dictate the classification of the location in which they perform their work. As we noted above, classification of offices should be based upon how they are held out to the public and whether or not customers are admitted. If neither of those conditions exists, the location should not be considered either a branch or an OSJ.

2. Remote office inspections

FINRA Rule 3110(c) specifies that member firms must conduct inspections of branch offices and OSJs on a prescribed schedule. OSJs must be inspected on an annual basis and branch locations every three years. We note that Rule 3110 does not specify the form of such examinations, and in particular whether the firm must physically inspect the location, but FINRA has taken the position that the required inspections must be done in person.

In recognition of the limitations imposed by the COVID pandemic, FINRA wisely issued relief from the physical presence requirement for calendar years 2020 and 2021, which is now embodied in Rule 3110.17. Prior to allowing FINRA to adopt the rule change granting this relief, the SEC requested public comments regarding this approach and received a very significant response.³ Many commenters, including Cetera, noted that they had effectively transitioned their entire branch office inspection process from in-person to virtual or remote. The development of facilities such as Zoom and Microsoft Teams has made the necessary technology available on a cost-effective basis to virtually anyone who wishes to utilize it. In 2020, Cetera conducted more than 1,500 branch

³ SEC File No. SR-2020-019. July 7, 2020.

inspections on a virtual basis. Our experience indicates that the nature and quantity of the items noted in these inspections is very similar to what we have historically seen when the inspections were conducted in person. The fact that virtually all inspections have been successfully completed by FINRA members under the relief afforded by Rule 3110.17 strongly indicates that branch inspections can be accomplished effectively without sending an employee to the office.

We would also note that, while the COVID-19 pandemic is a very unusual event, disruption of business operations on a significant scale is not unprecedented. Business interruptions arise out of many different circumstances, including weather and other natural disasters and acts of war or terrorism such as those experienced on September 11, 2001. It is inevitable that disruptions will occur in the future. All business organizations must be prepared to perform as many functions as possible on a remote and distributed basis. In light of that, FINRA should amend Rule 3110(c) to specifically permit member firms to implement their own process to determine how and when all offices (both branch offices and OSJs) are inspected. FINRA Rules 3110.12 and 3110.13 require member firms to undertake a risk-based review of branch locations to determine the frequency with which inspections must occur. We would extend this logic and propose the following specific amendments:

- Rule 3110(c) should be supplemented to provide that all FINRA member firms are required to perform a risk-based review of the activities conducted at all of their branches offices on an annual basis. Based on this assessment, firms would create and appropriately document their own regime for inspections, both as to physical presence and frequency. A similar concept for certain types of offices was proposed by FINRA in Regulatory Notice 17-38. Cetera and other commenters endorsed that approach, and FINRA should consider extending it now.
- While Rule 3110(c) does not specifically state that branch offices must be physically inspected, it has been FINRA's stated policy that physical presence is required.⁴ FINRA should make clear that the necessity of physical inspection of any branch office is to be determined by the member firm in accordance with its own risk assessment.

When FINRA adopted its temporary policy permitting virtual branch office inspections, the SEC received comments from many member firms regarding their experience with performing these inspections remotely. By now, member firms have a substantial body of data regarding these inspections and their effectiveness. We encourage FINRA to explore those experiences in more depth as a source of empirical validation on this issue.

⁴ See SEC File No. SR-2020-040. November 6, 2020.

II. Qualification examinations

Virtually all individuals who perform substantive tasks for a FINRA member are required to pass a qualification examination. This serves FINRA's primary objective of investor protection, and we endorse it a valuable mechanism to help ensure that individuals are properly qualified to perform their job-related functions. Prior to 2020, all FINRA qualification exams were required to be completed in testing centers operated by third parties. The COVID-19 pandemic effectively closed all of the testing centers and in many cases prevented individuals from gaining or beginning employment in the securities industry and prevented firms from hiring new or replacement workers. FINRA took several steps to alleviate this problem, including extending the periods in which applicants could complete examinations and developing an online testing service for certain examinations. Notice 20-42 notes that approximately 15,000 individuals have completed qualification examinations through the new online facility, without the necessity of travelling to a testing center. We believe this establishes that online testing is a viable and appropriate method for administering qualifications examinations on a permanent basis. It should be extended to all FINRA examinations and not limited to the current group. The integrity of the examination process is important, and unfortunately there have been instances in the past in which individuals attempted to circumvent the testing system. That being said, it would appear that FINRA has successfully dealt with security and proctoring, and should extend remote testing to all eligible individuals.

III. Engagement with FINRA

Member firms and their customers have not been alone in feeling the impact of the COVID-19 pandemic. FINRA and its staff were forced to react in real-time to change their operating methods. Physical visits to member firms and branches offices became effectively impossible, and other FINRA functions such as enforcement hearings and related testimony ground to a halt. For the most part, FINRA did an excellent job of responding to this emergency. It took actions that were thoughtful, timely, and realistic in addressing the burdens faced by member firms, and the FINRA team is to be commended for its efforts. We believe that the past year has also demonstrated that FINRA staff can effectively accomplish its regulatory and oversight mission with respect to member firms and associated persons on a virtual basis. We have two specific suggestions in that regard:

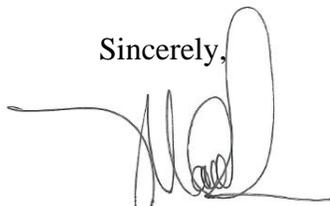
- All regular cycle examinations conducted by FINRA staff should be conducted remotely unless there is a specific reason to send examiners to the member firm's office. FINRA has made substantial progress in this effort over the past several years, and we submit that it has made the process more efficient for both member firms and FINRA staff without sacrificing effectiveness. Some situations, such as examinations for cause or examinations of new member firms may necessitate in-person contact. Otherwise, the benefits of in-person meetings are usually outweighed by their cost and inconvenience.

- FINRA should strongly consider expanding its use of standardized requests for information in connection with examinations. This will create efficiencies for both examiners and member firms.

As FINRA considers this issue, we suggest consideration of the following two questions: In 2019, how much time did FINRA examiners spend in transit to and from examinations or other visits to member firms, and what was the total cost of their travel? We suggest that the figures for both are large and could be reduced without any significant diminution of the overall supervisory effort or investor protection. All organizations, including FINRA and its member firms, are being pressed to create operating efficiencies and do more with less resources. Reducing travel time and expenses will assist FINRA in accomplishing these goals.

We appreciate the opportunity to provide these comments and the spirit in which FINRA has undertaken this retrospective rule review. If we can offer any further information or assist in any way, please let me know.

Sincerely,

A handwritten signature in black ink, appearing to read 'Mark Quinn', with a long horizontal flourish extending to the left.

Mark Quinn
Director of Regulatory Affairs
Cetera Financial Group