



February 12, 2021

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

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

Dear Ms. Mitchell:

Schwab first conveys our gratitude for the considerable efforts FINRA has demonstrated throughout the COVID-19 pandemic. The ability to have direct discussions, as well as timely and clear relief, allowed us to maintain our focus on employee safety and protect our clients without compromising our regulatory obligations. Schwab is equally committed with FINRA to protect investors, and the recommended changes reflected herein will not diminish that shared goal but further drive innovation in the industry. We further note that we are in an environment that continues to evolve and offer new lessons each day. To that end, we hope that FINRA will provide additional opportunities over the year to provide feedback. As set forth below, we highlight three areas where we believe FINRA can modernize existing rules and provide permanent relief to member firms without negatively impacting investor protection.

I. Supervision

We outline below the areas where FINRA could revisit its supervision rules to align more closely with today’s modernized and digitized world, an evolution only accelerated by FINRA’s relief as well as our collective experiences and advancements throughout the COVID-19 pandemic. We appreciate FINRA’s efforts to continue to give member firms flexibility in designing a reasonable supervisory program that aligns to their specific business by considering the changes proposed below.¹

The pandemic made our industry acutely aware that the physical location of, or supervisor’s physical proximity to, the associated person is less relevant to today’s supervisory program than it once was. Firms proved able to properly supervise representatives in remote locations, performing a wide range of functions, without compromising our commitment to investor protection. This was possible due to efforts made over the course of years prior to the pandemic, with automated reporting and alerts to add consistency, urgency, and efficiency to front-line supervision. In the case of many larger firms, these functions are vetted and overseen by a geographically dispersed series of centralized principals who can assess the risks identified. These principals do not rely solely on physical proximity to the individuals being overseen, as the data shows where research and escalation is necessary. Centralized principals escalate

¹ “FINRA would expect a member firm to establish and maintain a supervisory system that is reasonably designed to supervise the activities of each associated person while working from an alternative or remote location during the pandemic.” FINRA Regulatory Notice 20-08 (Mar. 9, 2020), available at <https://www.finra.org/rules-guidance/notices/20-08>.



matters for further review to supervisors who add value through their familiarity with the associated staff and circumstances, derived from regular and routine interactions and a network of monitoring tools rather than physical proximity. In our experience, this supervisory network, with its parts working in concert, does not necessitate physical proximity and is more scalable without compromising the supervision being conducted than reliance on a traditional in-person centric supervisory structure. This process builds upon the traditional human review with data-driven supervisory alerts which adds scale and ensures the supervisory discussions are more clearly focused on the true matters that deserve escalation. This reflects the reality at Schwab and at similarly situated firms, but the broader industry has followed suit by offering cost-effective vendor solutions and reporting which permits smaller firms to supplement their supervision and seek modernization in a similar fashion, where it serves their size and structure.

A. Office Locations

Consistent with the technological advances and modernization discussed above, we suggest FINRA consider amending its definitions regarding office locations as outlined below.

1. Office of Supervisory Jurisdiction

a. Definition

We suggest modernizing the OSJ classification² to narrowly focus on the specific locations that justify enhanced oversight. We suggest FINRA revisit the supervisory activities requiring OSJ registration, as the present definition speaks to a host of individual activities which, in the current environment, represent, in some cases, steps in broader, centralized processes. We suggest limiting an OSJ to a branch office location where in-person supervisory activities are conducted, or where customer funds or securities are accepted and held overnight. For example, as discussed below, the supervision of digital account openings, associated person conduct, and marketing and advertising are typically centralized, digital-first processes that can be conducted at any location with a secure data connection to company servers and systems. This recommendation is applicable to firms of all sizes as those activities still supervised in person would remain under an OSJ designation.

b. Updating Covered Activities

FINRA's rules prescribe that offices at which employees review new accounts, review and endorse customer investment banking and securities orders, and approve advertising communications should be deemed OSJs regardless of whether the activity is in person or not.³ FINRA could remove these provisions in their entirety or amend them to exclude firms that have availed themselves of technological advancements and digitized these activities and their supervision such that they are centrally hosted and evidenced on firm servers, regardless of where they are physically conducted.

² FINRA Rule 3110(f)(1).

³ See FINRA Rules 3110(f)(1)(D)-(F).



For example, while the final approval of communications is recognized as a critical step, it can be an entirely digital process. A communication can be drafted in California, revised in Texas, and approved in Colorado without relying on paper approvals or anyone's physical location. To the extent there are exceptions to those processes, policies and procedures should be in place to ensure that each document is handled appropriately through a Branch Office or mail. Throughout the COVID-19 pandemic, we have seen accelerated adoption of digital engagement by our customers for activities from check deposits to account openings and transfers without an increase in supervisory risk and we expect much of this behavior to continue. This is due in large part to that fact that the move to a digital-first model for engagement has been underway across the industry, with an associated time and cost-savings recognized, for some time and the infrastructure to support it is now more broadly in place. We are asking that the regulatory framework be brought in line with those industry advancements. This narrowing of the OSJ definition would also ensure that only those branch offices rising to the level of requiring OSJ supervision would be categorized as such as opposed to other corporate offices or call centers that may be unintentionally captured in today's definition.

c. Onsite Supervision

FINRA requires firms to designate an office as an OSJ where there is responsibility for the supervision of the activities of associated persons at one or more branch offices, which in effect means the location of each supervisor.⁴ This rule is similarly antiquated in a digital-first environment and we suggest that FINRA reconsider and potentially narrow it to include only in-person supervision, as the physical location of the supervisor alone no longer drives the majority of supervision being conducted.

The physical location of a supervisor is significantly less relevant today than when FINRA originally wrote this rule. At that time, the benefit of physical supervision included manual supervision through overhearing conversations in hallways, physically joining a phone call, or discovering documents in cabinets. Prior to COVID-19, and even more so since, firms have made supervisory discussions a routine part of every supervisor's role regardless of location, in many cases, largely conducted remotely. We have found this enhances, rather than stymies, communication between business personnel and their supervisors. With proper policies, procedures, systems, and controls in place, a firm's supervision team can conduct this activity from nearly any location, including a supervisor's residence, without compromising the controls surrounding customer protection.

2. Branch Office

FINRA's supervision rules set forth the definition of a "branch office,"⁵ and could be simplified to define a branch office solely as a location that is held out to the public for in-person interactions with registered representatives of a member firm and/or that physically accepts

⁴ See FINRA Rule 3110(f)(1)(G).

⁵ See FINRA Rule 3110(f)(2)(A).



currency or securities. All other locations that fall within the prescribed test,⁶ currently for an associated person's primary residence, should be designated as non-branch office locations and supervised with a risk-based approach tailored to the activities being conducted. Locations such as a corporate office containing non-client facing personnel, a registered person's remote work location, or any other location not held out to the public for in-person interactions should not rise to the level of branch office registration as it triggers an unduly burdensome inspection and supervisory obligation on firms without an equivalent customer protection benefit. This obligation is currently driven by perspective that these activities take place in a uniquely physical location where they may now actually take place virtually and are supervised centrally in a similar manner without regard to physical location.

Further, with this expansion, we suggest that FINRA eliminate the exclusion from the "branch office" definition any location other than a primary residence that is used for securities business for less than 30 days in any one calendar year.⁷ Such an exclusion would be captured in the expanded non-branch office definition above and the time-based criteria is therefore no longer necessary. During the pandemic, and with a view of life after, Schwab does not view a primary residence as unique from any other location that meets the criteria set forth in the outlined test under the rules.⁸ Finally, a modernization of these definitions will help firms find administrative efficiencies with related forms and filings such as Form BR.

B. Remote Inspections

We first acknowledge the outstanding efforts FINRA made in extending temporary relief to member firms on a remote basis given the events of 2020. FINRA should now consider extending that temporary relief provided on a permanent basis, as set forth below.

First, we encourage FINRA to consider permanently allowing member firms to conduct remote inspections of office locations to satisfy their applicable regulatory obligations under Rule 3110(c). The rule currently requires member firms to perform on-site⁹ inspections of all locations from which associated persons regularly conduct businesses, including where they are permitted to work remotely. FINRA adopted temporary relief to permit member firms to perform remote inspections of all offices and locations (*i.e.*, OSJs, supervisory and non-supervisory branch offices, and non-branch locations) through Calendar Year 2021.¹⁰ A permanent change to a remote exam process provides the needed flexibility to complete future inspections in a safe and timely manner. FINRA should consider fashioning permanent relief that allows remote

⁶ See FINRA Rule 3110(f)(2)(A)(ii).

⁷ See FINRA Rule 3110(f)(2)(A)(iii).

⁸ See FINRA Rule 3110(f)(2)(A)(ii).

⁹ See FINRA Regulatory Notice 17-38, *FINRA Requests Comment on a Proposal to Amend Rule 3110 (Supervision) to Provide Firms the Option to Conduct Remote Inspections of Offices and Locations That Meet Specified Criteria Comment Period Expires: January 12, 2018* (Nov. 13, 2017), available at <https://www.finra.org/rules-guidance/notices/17-38> ("FINRA has interpreted the rule to require that inspections take place on-site.").

¹⁰ See FINRA Rule 3110, Supplementary Material .17(a).



inspections as the primary directive, with a reasonable risk-based approach to the determination of how and when to conduct a physical onsite inspection. FINRA could develop this change in such a way as to allow all firms, based on available resources, to assess their individual capability to deliver an effective inspection and adjust accordingly. Indeed, allowing a reasonable risk-based approach to delivering onsite inspections allows those firms with advanced technology to deliver remotely an equally robust program as those firms with resource limitations requiring more onsite inspections.

Second, we recommend that FINRA exclude non-branch locations from any inspection requirement. Currently, the rule requires member firms to inspect on a regular periodic schedule every non-branch location, generally at least every three years.¹¹ Schwab believes, and we hope FINRA agrees, that not every location currently subject to the inspection requirement warrants inspection where a location does not engage in activities that present material risk of misconduct or harm. For example, consider that locations that do not hold themselves out to the public, do not meet with clients, do not distribute materials, or that do not accept funds and securities do not present the same level of risk as branch offices. We believe Schwab and other similarly situated member firms supervise, test, and monitor these locations for regulatory risk as part of an overall risk management program, and onsite or remote inspection adds limited value. We believe many firms can continue to effectively supervise employees, regardless of location, without requiring an inspection of every location where an employee utilizes technology to connect to firm systems, unless the firm believes from a risk perspective that an onsite inspection is warranted.

Third, if FINRA does decide to require, post-pandemic, inspections of non-branch locations, Schwab believes a reasonable risk-based approach, allowing firms to determine an appropriate sample of locations to inspect remotely, would alleviate an otherwise potentially untenable inspection requirement. Such an approach would lessen the burden on firms to inspect low-risk locations, which have grown in number as many move to alternative work arrangements, and instead allow firms to devote resources to inspecting its highest risk locations. Firms could then weigh and document the location's risk, such as the nature of business conducted, access to firm books and records, heightened supervision of certain persons, and access to firm capital. Schwab already performs a risk assessment of the business in which it engages, performing a similar risk assessment to determine a sample of locations to inspect that aligns with this existing methodology. This process would allow for greater flexibility in handling oversight of lower risk areas of firm business as more employees are working from remote locations, but still allow for a firm to address its highest risks through remote and, in highest-risk scenarios, onsite inspections. Allowing this approach provides a scalable solution for both small and large firms alike. FINRA should also consider inspection requirements in tandem with the definitions of branch office, non-branch location, and OSJ, as set forth above. Without a fundamental re-consideration of such definitions, the value of shifting inspection requirements greatly diminishes.

These changes will not reduce the effectiveness of inspections. The very nature of our

¹¹ See FINRA Rule 3110(c)(1)(C). A member establishing a longer periodic inspection schedule must document in its written supervisory and inspection procedures the factors used in determining that a longer cycle is appropriate. See FINRA Rule 3110, Supplementary Material .13.



industry has changed since the implementation of Rule 3110(c) and subsequent guidance, and the technological means to conduct remote inspections are widely available. To that end, Schwab conducted the majority of its branch inspection related work remotely prior to the pandemic. For example, before the pandemic, technology advances had eliminated onsite review of physical order tickets and printed trade blotters. Since the start of the pandemic, Schwab has largely removed funds and securities processing from branch locations and our inspection team utilizes video conferencing both to interview personnel and perform virtual site inspections. In 2020, Schwab's inspection program performed approximately the same number of branch inspections as prior years. We believe the already existing pre-pandemic inspection tools, coupled with the changes implemented during the pandemic, effectively modernized branch inspections. We recognize that there may not be a one-size-fits-all approach, and some firms may need to evaluate capacity and resources and conduct on-site inspections under their own risk-based model. But we encourage FINRA to not reverse the advances made during this period and require technologically capable firms to revert to mandatory onsite inspection requirements.

II. Qualification Exams

Schwab appreciates FINRA's efforts and partnership with Prometric to navigate the pandemic-related difficulties in exam scheduling. Additionally, we appreciate the work done to operationalize online remote examinations. Even with significant progress, we continue to experience up to a six-month delay in scheduling examinations due to limited availability. During the pandemic, Schwab, like other firms, continued its unprecedented growth to meet customer demand. While we hired qualified personnel to service this need, further delays in qualification exams create an undue burden in allowing the firm to meet client expectations and supervisory obligations. We suggest that FINRA include all qualification examinations in the online program and continue to advocate for increased scheduling availability. Given the many limitations on scaling in-person examinations, we encourage FINRA to more broadly embrace the recent success of the online remote examinations both in scope and availability, both during and after the pandemic. With the technological advances taking place in the industry currently, this would remove one of the most significant barriers to registration today.

III. Manual "Wet" Signature Requirement

We also encourage FINRA to eliminate the manual signature requirement under FINRA Rule 1010(c) to permanently allow member firms to submit applicants' electronic signatures on the Uniform Application for Securities Industry Registration or Transfer ("Form U4").¹² Due to the pandemic, FINRA granted temporary relief on March 18, 2020 by relaxing the manual signature requirement, so long as firms obtained the applicant's manual signature as soon as practicable.¹³ At its September 2020 meeting, FINRA's Board of Governors approved filing with the SEC proposed rule amendments to Rule 1010(c) and a conforming amendment to

¹² Commensurate with that change, we also ask that FINRA adopt a conforming amendment to FINRA Rule 2263.

¹³ See "Frequently Asked Questions Related to Regulatory Relief Due to the Coronavirus Pandemic," available at <https://www.finra.org/rules-guidance/key-topics/covid-19/faq>.



FINRA Rule 2263 to permit firms to obtain an electronic signature on Form U4.¹⁴ For the reasons set forth below, we concur with that proposal and strongly recommend the adoption of the amendments.

First, electronic signatures are a valid and widely used alternative to manual, or “wet,” signatures. The basic principle of the Electronic Signatures in Global and National Commerce Act (“E-Sign Act”), which was enacted in 2000, is that electronic signatures and records should be accorded the same legal status as wet signatures. *See generally* 15 U.S.C. § 7001(a) (2021). It was clear then that businesses and consumers were rapidly adopting use of the Internet as a significant means in which to purchase and sell goods and services, to communicate, and to effectuate agreements and contracts. Thus, the SEC’s adopting release on the use of electronic signatures supported the E-Sign Act and stated that electronically-signed documents are SEC-compliant so long as they comply with the document retention requirements of Exchange Act Rule 17a-4(f).¹⁵ The intervening two decades have made clear that digital commerce and communications are in widespread use.

Electronically signed documents are just as secure as paper documents while being more immediate, efficient, and cost effective. In fact, they offer certain safety features not available to paper communications, which are uniquely subject to physical theft, loss, corrosion, and negative environmental impact. Currently, Schwab’s process for obtaining manual signatures on Form U4 is inefficient and cumbersome. It requires sending the applicant a PDF copy of the Form U4, which the applicant must print, manually sign, scan, and email back to the Firm for retention on electronic storage media consistent with Exchange Act Rule 17a-4(f). As FINRA has previously noted in amending a similarly inefficient manual signature process under Rule 4512(a)(3), technological advances in electronic signatures include both authentication and security.¹⁶ FINRA should similarly consider amending Rule 1010(c) so long as the electronic signature clearly identifies the signatory and is otherwise in compliance with the E-Sign Act, the guidance related to the E-Sign Act, and the guidance provided by FINRA staff through interpretative letters.¹⁷

Second, amending these rules will further the policy of modernizing rules to acknowledge technological efficiencies, including the use of electronic signatures. *See, e.g.*, RN 19-13 (Apr. 16, 2019) (describing SEC amendment to FINRA Rule 4512(a)(3), allowing use of electronic signatures in connection with discretionary accounts); RN 11-19 (Dec. 5, 2011), available at <https://www.finra.org/rules-guidance/notices/11-19> (describing SEC amendment to FINRA Rule 4512(a)(1)(D) and that signature requirement denoting that customer account has been accepted

¹⁴ *See* “Report from FINRA Board of Governors Meeting – September 2020 (Sept. 18, 2020), available at <https://www.finra.org/media-center/newsreleases/2020/report-finra-board-governors-meeting-september-2020>.

¹⁵ *See* “Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media under the Electronic Signatures in Global and National Commerce Act of 2000 with Respect to Rule 17a-4(f), Release No. 34-44238 (May 1, 2001), available at <https://www.sec.gov/rules/interp/34-44238.htm>.

¹⁶ *See* Regulatory Notice 19-13 (Apr. 16, 2019), available at https://www.finra.org/sites/default/files/2019-09/Regulatory-Notice-19-13_0.pdf.

¹⁷ *Id.*



in accordance with member’s policies and procedures “may be satisfied through the use of electronic means”); Interpretative Letter to Jeffrey W. Kilduff, Esq., O’Melveny & Myers, LLP (July 5, 2001), available at <https://www.finra.org/rules-guidance/guidance/interpretive-letters/jeffrey-w-kilduff-esq-omelveny-myers-llp> (providing guidance that member firms could utilize electronic signatures to meet requirements of NASD Rule 3110(c)(1)(C)). As FINRA noted in the Regulatory Notice, Rule 1010(c) is the last vestige of manual signature requirements in the FINRA rulebook.

The most recent rule change in this area, to FINRA Rule 4512(a)(3), is instructive. There, the process required a manual, dated signature of each named natural person authorized to exercise discretion in an account. The SEC explained in its adopting release that “the proposal will simplify the process by which member firms validate the identity of an authorized associated person, and thereby lower costs to member firms by reducing operational inefficiencies.”¹⁸ A revision to Rule 1010(c) is warranted here for the same reasons.

Finally, the pandemic has significantly accelerated the ongoing shift in the financial services industry towards automated and electronic processes. As a pioneer in digital investing, Schwab continues to modernize and improve its digital offerings and is examining the needs for electronic signatures and delivery methods across the organization. In a digital, post-COVID world, now, more than ever, both consumer and business clients and employees expect to transact electronically, with its concomitant increased efficiency and associated cost benefits. Maintaining the status quo could, on the other hand, necessarily entail retaining the administrative inefficiencies associated with requiring firms to continue to adhere to a manual signature requirement just for Form U4s.

For the reasons stated, we strongly recommend that the Rule be amended to allow for electronic signatures. We also propose that the Rule be retroactively amended to March 18, 2020 so that financial services firms are not required to mitigate manual signatures once COVID-19 restrictions are lifted. This remediation work would require extensive resources, be paper intensive, and time-consuming.

We again express our appreciation for FINRA’s willingness to seek out member firms’ views on these critical issues impacting our industry in these times. Schwab recognizes its unique place in the industry in terms of technological sophistication and size, and we have styled our recommendations from that perspective given our own capabilities and infrastructure. We reiterate our desire to be able to continue to communicate our positions on these and other issues

¹⁸ Order Approving Proposed Rule Change Relating to FINRA Rule 4512 (Customer Account Information), Rel. No. 34-85282, at 6, available at <https://www.sec.gov/rules/sro/finra/2019/34-85282.pdf>.



later in the year as we continue to navigate towards a new normal, and we express our willingness to discuss these and any other items with the Staff at your request. Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read "Barbara Armeli". The signature is fluid and cursive, with a large, stylized initial "B" and "A".

Barbara Armeli
Senior Vice President
Chief Compliance Officer
Charles Schwab & Co., Inc.