

Regulatory Notice 20-42

Request for Comment

Business Continuity Plans (BCP)

What has been your experience with implementing Rule 4370 during the pandemic, including any ambiguities in the rule or challenges to comply with it?

When it was made available, we utilized the *FINRA Business Continuity Plan Template for Small Introducing Firms* to draft our initial BCP plan in accordance with rule 4370.¹ Over the years we have revised and updated our BCP as our business and operations changed. We had already been working towards structuring our normal operations to fully function in a remote capacity. The technological changes over the years implemented by our clearing firm, vendors and internal operations perpetuated our transition towards networked/cloud centric operations with remote capabilities. Therefore, only minor changes to our BCP were needed in response to COVID related operational changes.

Should FINRA consider any amendments to Rule 4370 to address issues raised during the pandemic?

No. Rule 4370 is well written to address the various aspects of a business without being too prescriptive. The rule itself is sound. The guidance provided by FINRA over the years has helped properly craft a comprehensive plan. There will likely be unique circumstances with any event that triggers the activation of a BCP. Firms will usually have to adapt and customize their response to some degree. However, those unique aspects should not serve as an indication that the rule needs to be amended or additional requirements implemented.

Did your firm's BCP plan directly or indirectly address the circumstances of the pandemic?

We did not specifically address a pandemic, but other scenarios and remedies were applicable to the circumstances the pandemic response presented.

Does your firm annually test its BCP? If so, are there any changes to testing warranted given what your firm has learned during the pandemic?

Yes. Our testing of the BCP was helpful to the management team and employees who were better prepared for the pandemic response.

Remote Offices, Alternative Work Arrangements and Remote Inspections

¹ <https://www.finra.org/compliance-tools/small-firm-business-continuity-plan-template>

Does your firm anticipate continuing to allow use of remote offices or alternative work arrangements by some personnel after the pandemic?

Yes. Through ongoing discussions with our employees the consensus has highlighted a focus on a “quality of life”. They have a new perspective. Some employees expressed that they value the personal interaction with co-workers and clients. Most realized how much of their time was wasted by long commutes to the office. For the majority of our employees, we foresee moving to a hybrid model of some days working in the office, perhaps even at varied times, and working remotely as needed and with that flexibility. Firm management and employees have seen how productive they can be when set up to correctly to work remotely. We are likely to enable this flexible work schedule so long as productively remains at normal levels.

If so, are there any ambiguities or challenges with FINRA rules that may prevent transition to broader use of remote offices or alternative work arrangements, including intersections with other laws or regulations?

Yes. Many of the FINRA rules still imply a brick n’ mortar structure, assuming supervision is limited to a building or a physical on-site presence to the associated persons being supervised. The technology implemented since the 1990’s has evolved beyond the limitation of physical proximity and use of eavesdropping. There is now a glaring disconnect with some of the Rule requirements and interpretations² and the realities of day-to-day business operations.

Principals and supervisors have a plethora of tools and resources available to conduct supervision, risk monitoring and compliance related functions. Some of these are intelligence based programs with proactive alert and enable a fluid, risk based approach. Many custodians enable new accounts to be approved on the custodial platform electronically with rep and principal approvals captured and time stamped in the platform system. In most cases, there isn’t a paper document handed from the rep to the principal. They execute the approvals from their desktop. Direct held applications can be executed via digital signature between the client, rep and principal. These individuals could be sitting next to each other or separated across the country. The questions to screen the new business and gather information obtained is the same. A popular tool for firms to use is a client relationship management (CRM) system for documenting client interactions, conversations, RegBI compliance, providing Form CRS, aggregating emails, and assigning service tasks. These systems enable reps and principals to interact and conduct supervisory obligations without local proximity.

² Notice to Members 98-38 NASD Reminds Members of Supervisory and Inspection Obligations establishes the regulatory expectation of inspections to be conducted on-site. Rule 3110(c) Internal Inspections does not specify the inspection methodology.

Recommendation:

- Amend terminology in the FINRA rule book referencing and requiring location based practices where the intent is not specifically a physical requirement. Buildings and locations do not supervise, people do.

Should FINRA consider any amendments to the branch office and OSJ definitions in Rule 3110? If so, what amendments do you suggest?

Yes, Rule 3110 needs to be modernized. It was once inconceivable and abstract for a company not to have a traditional office full of employees and instead opt for only a website and network of geographically dispersed employees. The reality now is that a firm could operate that way. Firms need only a principal place of business. A P.O. Box could be used for mail. All employees could operate remotely with no central “office”. Meetings could take place at the customers residence, public spaces or rented workspace locations. This example may not be a popular approach, but the point is that this model is possible. Many firms, well before the pandemic, were already moving towards streamlining and simplifying their back office operations to enable their professionals to have more time to service customers.

Locations justifying enhanced oversight should be distinguished from locations presenting low risk to investor harm or fraudulent activity.

Office of Supervisory Jurisdiction

With the exception of “maintaining custody of customers' funds or securities”, the conditions for designating an office an OSJ are no longer solely limited to a physical location. Per FINRA Rule 3110 (f)(1) "*Office of Supervisory Jurisdiction*" means any office of a member at which any one or more of the following functions take place. (The conditions that are not necessarily limited to a physical location have a strikethrough.)

- ~~(A) order execution or market making;~~
- ~~(B) structuring of public offerings or private placements;~~
- (C) maintaining custody of customers' funds or securities;
- ~~(D) final acceptance (approval) of new accounts on behalf of the member;~~
- ~~(E) review and endorsement of customer orders, pursuant to paragraph (b)(2) above;~~
- ~~(F) final approval of retail communications for use by persons associated with the member, pursuant to Rule 2210(b)(1), except for an office that solely conducts final approval of research reports; or~~
- ~~(G) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.~~

Compliance with the current definition can have unintended consequences for firms and representatives. Here is an example of this:

1. Scenario: Supervisors and representatives are working from locations other than a registered branch office (i.e. from their home).
2. Per Rule 3110 OSJ condition (f)(1)(G) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member, the firm registers a supervisor's residence as an OSJ as they are a supervisor performing this function.
3. A Form BR is filed for the supervisor's residence. His/her home is now a registered OSJ. (Under 1.G "this is a private residence" is checked).
4. The representatives' U4 "Office of Employment Address" is updated to reflect "Supervised From" the supervisor's registered OSJ. The employee is working from home so their "Located At" address is not a registered location.
5. On FINRA Broker/check, the address displayed on the representative's BrokerCheck report, for the public and investors to view, is now the supervisor's home address, which is a registered OSJ. This is a problem in many aspects.
 - a. The supervisors address is not intended to be 'held out to the public', it is not open to the public, nor available for customers to visit, nor is it intended to serve as a location to receive firm correspondence. This creates a privacy issue as well for the supervisor.

The definitions of OSJ and Branch Office and their applied use throughout the broker-dealer industry is complex. Therefore any change to the definitions will have ripple effect throughout the Rule book, at firms, with representatives and with the states. However, given what we know about the realities of the industry, these definitions are antiquated. For years now, FINRA has implemented retrospective rule review initiatives which have resulted in significant changes³ and a movement towards modernization. The industry will continue to evolve, the Rules must stand up to protecting investors and safeguarding market integrity in a manner that facilitates vibrant capital markets. If ever there is a time to evolve, it is now.

Suggestion to amend definition of OSJ:

- (1) "Office of Supervisory Jurisdiction" means a location of a member at which any one or more of the following functions take place:
 - (A) maintains custody of customers' funds or securities;
 - (B) serves as the principal place of business; or

³ FINRA Retrospective Rule Review, <https://www.finra.org/about/finra-360/progress-report/retrospective-rule-review>

- (C) requires in-person, on premise, supervision by the member

Branch Office

Define the circumstances for a location to be registered as a Branch Office. All other locations would be non-branch locations.

(A) A "branch office" is:

- a. any location designated by the member as such;
- b. a location where the member maintains original books and records per SEA 17a-4; or
- c. where one or more associated persons of a member regularly conducts the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of, any security or is held out to as such, excluding:
 - (i) Any location that is established solely for customer service or back office type functions where no sales activities are conducted and that is not held out to the public as a branch office;
 - (ii) Any location that meets the following conditions:
 - ~~a) Only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct member business at the location;~~
 - b) The location is not held out to the public as an office and the associated person does not meet with customers at the location;
 - c) Neither customer funds nor securities are handled at that location;
 - d) The associated person is assigned to a designated branch office, and such designated branch office is reflected on all business cards, stationery, retail communications and other communications to the public by such associated person;
 - e) The associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with this Rule;
 - f) Electronic communications (e.g., e-mail) are made through the member's electronic system;
 - g) All orders are entered through the designated branch office or an electronic system established by the member that is subject to the firm's supervision in accordance with this Rule; and
 - h) Written supervisory procedures pertaining to supervision of sales activities are maintained by the member.

(iv) Any office of convenience, where associated persons occasionally and exclusively by appointment meet with customers, which is not held out to the public as an office; *

(v) Any 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 identifying such location also sets forth the address and telephone number of a designated branch office or OSJ. ~~the location from which the associated person(s) conducting business at the non-branch locations are directly supervised;~~

(vi) The Floor of a registered national securities exchange where a member conducts a direct access business with public customers; or

(vii) A temporary location established in response to the implementation of a business continuity plan.

~~(B) Notwithstanding the exclusions in subparagraph (2)(A), any location that is responsible for supervising the activities of persons associated with the member at one or more non-branch locations of the member is considered to be a branch office.~~

(C) The term "business day" as used in paragraph (f)(2)(A) of this Rule shall not include any partial business day provided that the associated person spends at least four hours on such business day at his or her designated branch office during the hours that such office is normally open for business.

To account for the changes to the Branch Office definition, the U4 should be revised as such.

Revise U4

Change the context of the U4 "Office of Employment Address" to:

"Located At" reflects an OSJ or Branch Office an associated person uses as their primary office, (not required)

"Supervised From" reflects the address of the designated registered OSJ or Branch Office that serves as the associated person's address related to member activity, receipt of correspondence, and is the location reflected on all business cards, stationery, retail communications and other communications to the public subject to member supervision; (not the location of their supervisor)

Revise Form BR Explanation of Terms Person-In-Charge

A natural person, associated with the applicant and appropriately registered, ~~who is physically located at a non-OSJ branch office~~ and who has been designated by the applicant to manage the activities of the individuals working at the branch office. The Person-in-Charge is not required to be registered in a principal capacity with the applicant.

Supervisor

A natural person, associated with the applicant and appropriately registered in a principal capacity with an SRO, ~~who is physically located at an OSJ branch office~~, serving in a supervisory capacity.

If your firm has inspected any branch office remotely, did your firm experience any challenges conducting the remote inspection? What criteria does your firm use to determine whether a remote or onsite inspection is appropriate for a location?

We have inspected branch offices remotely. No material challenges. To determine the methods and scope of the inspection, we considered the following regarding the representatives associated with the respective branch:

1. Current supervision structure.
2. Business activity: complexity, type and volume of business.
3. Material changes to business; abnormal client departure or increase, new products.
4. Any policy violations or concerns by compliance department.
5. Access and method to review branch records: client files, trading activity, direct applications, emails, social media postings, and other related records on an ongoing basis.
6. Customer complaints, heightened supervision measures or restrictions places on representative(s).
7. Outside business activity concerns.
8. Previous branch deficiencies, disciplinary history.
9. Other circumstances and factors unique to the representative(s).
10. Firm resources and level of risk posed by representative.

What methods has your firm used to conduct remote inspections?

The branch inspector was able to use smart phone video calls to facilitate an interactive, live tour and walk-through of each location. Th inspector reviewed physical aspects, met family members at resident locations, and reviewed key aspects of the location. The inspector was able to review the equipment at the location and take photos using the smart phone to demonstrate and document aspects of the inspection. We approved and utilized the use of an expansive list of publicly available tools and online resources. These methods were in addition to the existing supervision system and network access already available to the inspector.

What methods has your firm used to supervise personnel working remotely?

What business changes have you made in order to comply with supervision requirements?

The current infrastructure is set up to supervise employees in the same manner – remote or in-person. We did modify how the mail is processed. A designated employee opens the mail and instead of placing mail in the employees’ mail cubby, they scan the correspondence into a designated folder for the employee on the network at the same time they scanned it for “Incoming Correspondence” records. They press two buttons instead of one. The employees can access their mail as PDFs once they log onto the network – which can be done from almost anywhere.

Engaging with FINRA and FINRA Processes

Should FINRA consider any changes to rules or their application, administrative processes or operations for more effective engagement among member firms, firm personnel, investors and FINRA staff?

- **ONLINE EXAMS.** To recruit and retain qualified professionals that need more flexible work arrangements and are in areas that present geographical challenges, enable remote online testing to be a permanent option for qualification exams.
- **DIGITAL SIGNATURES.** Enable the use of digital signatures per E-SIGN Act related to FINRA Rules.
- **IM-1011-1. SAFE HARBOR FOR BUSINESS EXPANSIONS** Issue relief regarding the Number of Offices (registered or unregistered) applicable to membership agreement.
Under the current definition of branch office, with a majority of employees’ working from home, many of their homes could be categorized as “unregistered” or non-registered branch offices and applicable to this count. So thus an overwhelming number of firms utilizing the Safe Harbor theoretically would need to submit a Rule 1017 application to obtain FINRA's approval of the expansion. The antiquated nature of this Rule presents firms with a predicament which was likely not the intention of the Rule.

Can FINRA make its procedural rules, guidance or attendant administrative processes more efficient and effective? If so, how?

Over the years we have noticed the FINRA’s attention to explaining the rules and providing enhanced guidance and best practices. The virtual conferences, podcasts, Notice to Members and development of firm tools have and helped firms implement policies and procedures to better address the issues at hand, thus improving industry oversight and investor protection.

Investors' Experiences

What impacts on investors, if any, have resulted from pandemic-related changes to member firms' operations and business models? For example:

- a. Have investors experienced any difficulty accessing their funds or securities during the pandemic?***
- b. Have investors experienced any challenges in communicating with registered representatives or member firms during the pandemic?***
- c. Which other customer services, if any, were impaired in material ways during the pandemic?***

No. Thankfully the transition has been fairly seamless.

What feedback have investors provided concerning pandemic-related changes to member firms' operations and business models?

Have investors requested any changes to firms' business processes or procedures in light of the pandemic environment?

Reps have been meeting with clients virtually. Our offices are currently closed to the public with access on a scheduled basis. When conditions allowed to meet in-person some clients requested that.

What changes in retail investor behavior, if any, have been observed during the pandemic?

Like everyone else, retail investors have had a chance to reflect on their life, what is important to them, what they need to maintain a healthy lifestyle, their goals and new possibilities. For some, including retirees, they spent less this past year – saving what they would have spent traveling and on other discretionary activities. They built up additional savings. Some investors are contemplating making drastic lifestyle changes - selling their house and moving to another region, some even moving looking to move abroad.

This past year demonstrated a stronger need for the financial professional-client relationship. The financial professionals and employees did a lot of hand holding, explaining, listening, and servicing clients to help them through this difficult and uncertain time. With the increase of cyber hacking and scams we tried to educate our clients as much as we could about how they can protect themselves and what to look out for. Even some of the 'do it yourselfers' reached out for professional and educated guidance.

Respectively,

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CCO of a retail, small firm broker-dealer

