



VIA ELECTRONIC MAIL

January 12, 2018

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

RE: Regulatory Notice 17-38 – Proposal to Amend Rule 3110

Dear Ms. Piorko Mitchell:

In its Regulatory Notice 17-38 (“RN 17-38”), the Financial Industry Regulatory Authority, Inc. (“FINRA”), solicited comments regarding a proposal to amend Rule 3110 (Supervision) (hereinafter “Proposed Amendment”) to provide firms the option to conduct remote inspections of offices and locations that meet specified criteria.

Commonwealth Financial Network® (“Commonwealth”) is an independent broker/dealer and an SEC-registered investment adviser with home office locations in Waltham, Massachusetts, and San Diego, California, and more than 1,700 registered representatives and investment adviser representatives (collectively “advisors”) who are independent contractors conducting business in all 50 states.

Commonwealth supports FINRA’s Proposed Amendment, as it will allow firms to streamline their compliance inspection process for “qualifying offices” and deploy their oversight resources to activities that present greater investor protection risks. As described in further detail below, however, the Proposed Amendment would be further enhanced by removing the first two criteria from the Supplementary Material of Rule 3110.15(b). The limit on the number of associated persons conducting business from the location is arbitrary, and removing the restriction on holding the location out to the public will increase the pool of locations available to firms for consideration of a remote examination. These changes would not create a significant or meaningful increased risk to investor protection. Firms continue to have an obligation to evaluate the reasonableness of a remote exam based on the considerations described in Rule 3110.12, and these changes would allow firms to better leverage and utilize their limited resources to focus on more pertinent risk areas.

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Questions Raised in RN 17-38

Q1. How does the firm currently fulfill its obligations under Rule 3110(c) for those offices or locations at which few associated persons reside and limited or low-risk activities occur? In what way(s) would the use of remote inspections impact the firm's current inspection process or practices?

A1. The Commonwealth Compliance department currently visits its roughly 1,300 registered branch offices and 350 non-branch locations no less than once every three years. Of these locations, approximately 300 branch offices and the 350 non-branch locations would meet a common-sense definition for Commonwealth of locations where limited or low-risk activities occur. These are locations established by advisors to meet locally with their clients and prospective clients, but do not operate as traditional branch offices at which Commonwealth books and records are maintained.

Whereas Commonwealth conducts the majority of its oversight activities electronically or from the advisors' primary branch location, the review of these locations is substantially streamlined. These reviews rarely result in an exam finding. When an exam finding does occur, it is administrative or otherwise immaterial. The reviews take approximately 4 hours to complete based upon travel time to and from the location, conducting the review itself, and subsequent documentation of the visit. The use of remote audits would allow examiners to review these locations remotely during the exam of the advisors' primary branch in coordination with Commonwealth's standard and ongoing electronic reviews, allowing the firm to redirect resources to more frequent and in-depth examinations of advisors' primary locations. Further, firms will have the opportunity to better utilize their technological resources to conduct their oversight activities, reduce the travel schedule for examiners, and redirect resources to other areas of risk that would enhance investor protection.

Q2. Should a firm with a disciplinary history of supervisory violations or other investment related violations be able to avail itself of the option to conduct remote inspections?

A2. Whether a firm has a disciplinary history of supervisory violations or other investment-related violations should not automatically disqualify the firm from availing itself of the option to conduct remote inspections. The firm still has an obligation under the Proposed Amendment to consider the factors in Rule 3110.12 in its determination of certain locations that would be eligible for a remote examination.

It is reasonable, however, that FINRA exclude "severely disciplined firms" as defined by Rule 3170.

Q3. Are there other criteria for a “qualifying office” that should be considered?

For example:

- a. The proposal requires a firm to determine whether a remote inspection of a qualifying office would be reasonable by considering the factors set forth under Rule 3110.12 including the volume of business. Should a threshold be imposed on the volume of business generated from the qualifying office, or should offices that are responsible for a significant proportion of a firm’s business be excluded from the definition?**
- b. Should there be a prerequisite that a firm must have conducted an on-site inspection of an office or location before such office or location could become a qualifying office?**
- c. Should the firm be required to conduct an interview with the associated person(s) designated to the qualifying office by video conference or in-person at any mutually agreed upon office or location?**
- d. Should there be a minimum distance between the qualifying office and the OSJ or supervisory branch office?**

A3. No. Adding proscriptive thresholds or limitations such as those described above would not further enhance investor protection and would create an administrative burden that would render it difficult for firms to track their “qualifying offices”. A firm’s written supervisory procedures should address the pertinent characteristics the firm has used in establishing its remote branch examination program.

Q4. The proposal seeks to limit the number of associated persons designated to a qualifying office to three. Is this threshold reasonable? If not, why not? Is there a more appropriate threshold and why?

A4. The proposed condition limiting the number of associated persons in a “qualifying office” to three should be removed from the Proposed Amendment. This is an arbitrary limit that will have unintended consequences with no benefits to investor protection. For example, client relationships quite often are managed by a group of three or more “service advisors.” If a location has been established to meet with clients for the convenience of those clients, a firm would either have to choose to limit which advisors might use the location or establish a process to monitor how many advisors use the space over a period of time to determine if an on-site examination is required.

Similarly, this condition will disproportionately affect bank and credit union financial services programs, which more routinely utilize additional branch locations. Many bank programs have numerous advisors who are assigned to the bank’s various branches for the servicing of client accounts. Proposing a hard limit as to the number of associated persons would render this proposal unworkable for that business model.

Q5. Are there criteria for a qualifying office that should be excluded?

A5. Yes. FINRA should also remove the “held out” criteria in the Supplementary Material of Rule 3110.15(b)(2). The essence of the Proposed Amendment is that firms must determine if they are able to dispense their oversight responsibility of a location remotely. This determination should be made based upon the actual activities occurring from the location, as well as the firm’s technological capability to dispense its oversight, rather than whether the location is “held out.” For instance, an advisor may rent space by the hour from a vendor like Regus that is more convenient for some of his or her client meetings than is the primary branch location. It provides legitimacy for the location and is to clients’ benefit that the location is listed on the advisor’s website or business cards. There is limited additional protection in requiring an on-site examination of the location simply because it is held out to the public.

Q6. Does the proposal have any potential negative impacts on a firm’s ability to fulfill its obligations under Rule 3110(c)?

A6. Commonwealth does not anticipate any potential negative impacts on its ability to fulfill its obligations under Rule 3110(c).

Q7. Are there any material economic impacts, including costs and benefits, to investors, issuers and firms that are associated specifically with the proposal?

A7. Yes.

If so:

Q7a. What are these economic impacts and what are their primary sources?

A7a. There would be a positive economic impact to Commonwealth with a revision of this rule, as it would allow for a more productive use of our limited compliance resources. Commonwealth’s expenses associated with on-site compliance inspections include employee salaries and associated travel costs, and those expenses would decrease with the adoption of this rule. Commonwealth’s on-site inspection costs typically exceed \$500 a day.

Q7b. To what extent would these economic impacts differ by business attributes, such as size of the firm or differences in business models?

A7b. The independent broker/dealer model is directly affected, as these firms tend to have more branches per advisor than an employee registered representative model does and generally rely upon a centralized supervision model. Independent firms have spent years developing electronic books and records and oversight systems that allow for streamlined remote examinations of their field force, rather than relying on a paperwork-intensive on-site exam program. Due to the massive advancement of technological tools, firms have employed myriad means to conduct reasonable, ongoing oversight of advisor

branch offices from centralized locations, repurposing the time and capital expense in conducting on-site reviews.

Q7c. To what extent would these economic impacts affect existing business models and existing organizational structures?

A7c. Commonwealth would not change its business model or organization structure as a result of the Proposed Amendment. Rather, we would have the opportunity to redirect valuable resources to other targeted areas of risk through the elimination of nonproductive on-site exams.

Q7d. What would be the magnitude of these impacts, including costs and benefits (e.g., travel, infrastructure, human resources)?

A7d. Commonwealth estimates that it could reassign more than 850 employee hours of effort annually if it were able to migrate to a remote examination process for its qualifying offices.

Q7e. How many and what percentage of your firm's branch offices and non-branch locations do you estimate would be able to take advantage of the remote inspection option?

A7e. Commonwealth estimates that it would be able to take advantage of a remote exam process for the majority of its 350 unregistered locations and approximately 300 of its 1,300 registered locations, provided that the first two criteria from the Supplementary Material of Rule 3110.15(b) are eliminated. If only the "three associated persons" limit were to be eliminated, Commonwealth estimates that it would be able to take advantage of the remote inspection option for approximately 350 of the firm's branch offices.

Q8. Are there any expected economic impacts associated with the proposal not discussed in this Notice? What are they and what are the estimates of those impacts?

A8. No.

Conclusion

Commonwealth applauds FINRA's efforts to respond to the industry trend toward a more mobile and technologically competent and efficient system of supervision. The Proposed Amendment is a step in the right direction, but FINRA should take it a step further and allow firms the option to remotely inspect branch locations as well. FINRA could accomplish this by allowing locations that are "held out to the public as an office of the member" to meet the definition of a "qualifying office." This would have a significant positive impact on Commonwealth's ability to apply its compliance resources to higher-risk areas.

Jennifer Piorko Mitchell
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Commonwealth appreciates the opportunity to comment on the Proposed Amendment. If you have any questions regarding our comments or concerns, please contact me directly at 781.663.9615.

Sincerely,

Matthew Sugden
Director, Compliance
Commonwealth Financial Network