



August 23, 2022

**VIA ELECTRONIC MAIL (rule-comments@sec.gov)**

Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

**Re: *Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision); File No. SR-FINRA-2022-019; Release No. 34-95379***

Dear Ms. Countryman:

The Securities Industry and Financial Markets Association (“**SIFMA**”)<sup>1</sup> appreciates this opportunity to provide the Securities and Exchange Commission (the “Commission” or “SEC”) with comments in response to the Financial Industry Regulatory Authority Inc.’s (“**FINRA**”) File No. SR-FINRA-2022-019: Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision) (the “**Proposal**”).<sup>2</sup>

SIFMA and its members would like to thank the SEC, FINRA, and their staff for their extraordinary efforts during the COVID-19 pandemic. The SEC and FINRA have been outstanding partners in coordinating with the industry and responding to the various challenges presented by COVID-19. As we continue to navigate these uncertain times, we anticipate our engagement with the SEC and FINRA will continue to be collaborative as we determine how to regulate in a post-COVID-19 world.

SIFMA appreciates the significant effort that FINRA and its staff have invested in the Proposal, which reflects meaningful input from fellow regulators and the industry. SIFMA supports the Proposal and commends FINRA for modeling the Residential Supervisory Locations classification after the longstanding primary residence and non-primary residence exclusions that have been in effect since 2005. Given the current and anticipated state of hybrid work and the supervision arrangements regarding them, SIFMA

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<sup>1</sup> SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the United States and global capital markets. On behalf of our industry’s nearly one million employees, we advocate for legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (“**GFMA**”).

<sup>2</sup> FINRA, *Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision)*, File No. SR-FINRA-2022-019, 87 Fed. Reg. 47248 (Aug. 2, 2022), <https://www.finra.org/rules-guidance/rule-filings/sr-finra-2022-019>.

encourages swift adoption of the Proposal. SIFMA also requests that the SEC and FINRA consider a few modifications to the Proposal, as outlined in this comment letter.

SIFMA also applauds FINRA's broader efforts to review and update its rules, guidance, and interpretations post-pandemic. The revisions under the Proposal exemplify the benefits of FINRA's rule review process when it incorporates a studied approach that accounts for the real-world implications of regulations without compromising important investor protections and industry standards. SIFMA encourages FINRA to consider additional changes consistent with the objectives underlying the Proposal, including the areas highlighted in this letter and in our prior letters on these subjects.<sup>3</sup>

## ***I. Background Support for the Proposal***

The COVID-19 pandemic forced a fully alternative work environment upon the industry and a fundamental shift in workforce expectations. Supported by technological advancements made over the past decade by the industry, employees know they can do their jobs from any physical location and are demanding workplace flexibility. This requires an update to the outdated in-person and paper-based rules. This rapid adoption of alternative work location arrangements forced upon the industry by the pandemic has showcased capabilities built up over the last decade that allow firms to conduct comprehensive supervision of their associated persons electronically. These capabilities have been in use for years and are location agnostic, even if, they were largely utilized from within brick-and-mortar office locations before the pandemic. As such, these technological capabilities facilitate supervision from two rows away, in another building across town, or at an alternative work location. In many respects, technology permits firms to have a continual virtual eye on their staff.

In recognition of the sea of change in culture and technology that has occurred, and will accelerate over time, and its impact on the industry's supervisory capabilities, the Proposal would modernize the Supervision rule through aligning FINRA's definition of an office of supervisory jurisdiction ("OSJ"), and the classification of a location that supervises activities at non-branch locations, with the existing residential exclusions set forth in the branch office definition. This would enable firms to treat a private residence at which an associated person engages in specified supervisory activities as a non-branch location, subject to safeguards and limitations.

The primary impact of the Proposal would be that, as a non-branch location, a Residential Supervisory Location would become subject to inspections on a regular periodic schedule, rather than the annual inspection required of OSJs and other supervisory branch offices. Absent this change, when the temporary Form BR relief ends,<sup>4</sup> firms would need to choose between either forcing their workforce back in the office, thereby risking loss of key talent in a difficult labor market and potentially reducing employee safety, or exponentially increasing compliance burdens by registering thousands more private residences as

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<sup>3</sup> See SIFMA Comment on SR-FINRA-2020-019 (July 28, 2020), <https://www.sec.gov/comments/sr-finra-2020-019/srfinra2020019-7488707-221392.pdf>; Comment on FINRA Regulatory Notice 20-42 (Feb. 16, 2021), <https://www.finra.org/sites/default/files/NoticeComment/SIFMA%20%5BKevin%20Zambrowicz%5D%20-%20FINRA%2020-42%20COVID-19%20Impact%20SIFMA%20Comment%20Letter%20Final%20as%20Filed%20with%20FINRA%20on%20%202016%202021%20Zambrowicz.pdf>; and Comment on SR-FINRA-2022-001 (Feb. 16, 2022), <https://www.sec.gov/comments/sr-finra-2022-001/srfinra2022001-20116268-267910.pdf>.

<sup>4</sup> Pursuant to pandemic-related relief granted in March 2020, member firms have not been required to maintain updated Form U4 information regarding office of employment address for temporarily relocated registered persons, nor submit branch office applications on Form BR for any newly opened temporary office locations. See Regulatory Notice 20-08 (Mar. 2020) ("Notice 20-08").

OSJs, subject to yearly inspections.<sup>5</sup> Notwithstanding their technological capabilities and even size, our members do not have the staff to conduct such a substantial and sudden increase in the volume of annual residential inspections and, as the Proposal notes, such annual inspections are not necessary for this population.

More specifically, under the Proposal, an associated person's private residence where supervisory activities are conducted shall qualify as a non-branch location, provided that the long-standing residential exclusions are met, in addition to certain additional new criteria. The nine historic criteria require that the residential supervisory locations must (1) have only one (or a family of) associated person(s) conducting business at the location;<sup>6</sup> (2) not be held out to the public as an office; (3) not be utilized for meetings with customers or prospective customers; (4) ensure any sales activity taking place at the location complies with the current primary and secondary residence exclusions in Rule 3110(f)(2)(A)(ii) and (iii);<sup>7</sup> (5) not handle customer funds or securities; (6) ensure that the associated person(s) are assigned to a specific branch office; (7) ensure communications with the public are subject to the firm's supervision; (8) use electronic communications solely within the broker-dealer's electronic system; and (9) be included on a list of residence locations maintained by the member. The proposal also adds a tenth condition, a restriction from maintaining original books and records at such location. Lastly, the Proposal introduces nine new criteria for certain "ineligible locations."<sup>8</sup>

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<sup>5</sup> See 87 Fed. Reg. 47257 ("Residential non-branch locations have increased by 12,921 (53%). Some of these new residential non-branch locations would have needed to register as OSJs if not for the temporary suspension of the Form BR requirement and will need to register as OSJs unless the proposed rule change is adopted. Further, some of the 1,910 private residences that are currently registered as OSJs, described above, might be able to become Residential Supervisory Locations if the proposed rule change is adopted. The numbers suggest that the number of offices and locations that may benefit from the proposed rule change is in the thousands.").

<sup>6</sup> SIFMA encourages FINRA to consider modernizing this condition to take into account certain living arrangements that have become more prevalent since 2005. For instance, the proposal does not account for roommates, domestic partnerships, and similar residential arrangements that exist, particularly among younger employees. Two supervisors residing together poses no greater risk than two supervisors of the same family residing together.

<sup>7</sup> The Proposal appears to have some technical inconsistencies with FINRA Rule 3110(f)(2)(A)(ii) and (iii). For instance, the Proposal uses the term "private residence," whereas Rule 3110 uses the term "primary residence." Moreover, the Proposal indicates that an "associated person's private residence, other than a primary residence, remains subject to the less than 30-business-day in any calendar year limitation" in Rule 3110(f)(2)(A)(iii). *Id.* at 47254, n. 67. However, the primary benefit of the secondary residence distinction is that member firms do not have an obligation to maintain a list of secondary residence locations, which is an explicit requirement under proposed Rule 3110.19(a)(9) for all private residences. Therefore, it is unclear if the use of "private residence" is meant to move away from the primary/secondary residence distinction and if not, what purpose is served by maintaining such a distinction.

<sup>8</sup> Proposed FINRA Rule 3110.19(b):

A location shall not be eligible for designation as a non-branch location in accordance with Rule 3110.19 if:

- (1) the member is designated as a Restricted Firm under Rule 4111;
- (2) the member is designated as a Taping Firm under Rule 3170;
- (3) the member is currently undergoing, or is required to undergo, a review under Rule 1017(a)(7) as a result of one or more associated persons at such location;
- (4) one or more associated persons at such location is a designated supervisor who has less than one year of direct supervisory experience with the member;
- (5) one or more associated persons at such location is functioning as a principal for a limited period in accordance with Rule 1210.04;

## II. *Comments*

- a. SIFMA supports FINRA’s Proposal to modernize its rules by adding a Residential Supervisory Location definition.

SIFMA supports the Proposal, which represents a significant enhancement of the office registration and classification regime. The current location-based regulatory framework provides different classifications of offices with regulatory consequences that attach to each depending on the office location and scope of activities performed. The structure for office registration and supervision is then based on the nature of the activity or the supervisory role of the person conducting the activity.

For over two years, the industry has operated largely on an alternative work location basis and has shown through the current “pilot program” that it can properly supervise its various locations, registered representatives, and lines of business from any work location without compromising our commitment to investor protection.<sup>9</sup> As such, the proposed Residential Supervisory Location definition will enable firms more flexibility to implement a risk-based approach to work locations and inspection timelines, thereby enabling firms to more efficiently deploy compliance resources to maximize investor protection. With the technological advances and shift in business practices over the last two decades, there is no reason why supervisory personnel should be prohibited from taking advantage of the residential exclusions afforded to other registered representatives since 2005.

- b. SIFMA believes the Proposal can be modified to serve FINRA’s goals, while better aligning with current rules and practices.

SIFMA supports FINRA’s goal of promoting investor protection through identification of certain ineligibility criteria. SIFMA encourages FINRA, however, to consider if such proscriptive criteria are necessary for investor protection in light of current member obligations, the diversity of business models in the industry, and the pace of innovation. Instead, FINRA could modify the Proposal to make it more technology agnostic and thus “future proof” by instead modeling the “ineligible locations” section as a general presumption of ineligibility, in line with that introduced in FINRA Rule 3110.13, which would

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(6) one or more associated persons at such location is subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or state regulatory agency;

(7) one or more associated persons at such location is statutorily disqualified, unless such disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member and is not subject to a mandatory heightened supervisory plan under paragraph (b)(6) of this Supplementary Material or otherwise as a condition to approval or permission for such association;

(8) one or more associated persons at such location has an event in the prior three years that required a “yes” response to any item in Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a), 14C, 14D and 14E on Form U4; or

(9) one or more associated persons at such location is currently subject to, or has been notified in writing that it will be subject to, any investigation, proceeding, complaint or other action by the member, the SEC, a self-regulatory organization, including FINRA, or state securities commission (or agency or office performing like functions) alleging they have failed reasonably to supervise another person subject to their supervision, with a view to preventing the violation of any provision of the Securities Act, the Exchange Act, the Investment Advisers Act, the Investment Company Act, the Commodity Exchange Act, or any rule or regulation under any of such Acts, or any of the rules of the MSRB.

<sup>9</sup> See Securities Exchange Act Release No. 90454 (Nov. 18, 2020), 85 FR 75097 (Nov. 24, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-040).

require deviations from the presumption to be documented in a member’s written supervisory and inspection procedures, including the factors considered in such determinations.

This is particularly appropriate as currently, the requirement to conduct on-site inspections is an interpretation, not a rule, and under Rule 3110.12, members are already required to conduct annual reviews of their businesses, which must be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations and with FINRA rules. The rule further lays out specific considerations that a member must account for, which would encompass all of the currently proposed ineligibility criteria.<sup>10</sup>

The most salient example as to why a more flexible approach might be prudent and beneficial for regulators, investors, and the industry is the currently proposed disqualification in 3110.19(b)(4) for “a designated supervisor who has less than one year of direct supervisory experience *with the member.*” (emphasis added). Absent evidence that firms are regularly experiencing supervisory deficiencies due to permitting designated supervisors without an adequate amount of experience to work from home, SIFMA suggests that FINRA consider leaving this determination to the members themselves.<sup>11</sup>

Alternatively, SIFMA encourages FINRA to more narrowly tailor this provision to directly address its concerns. As currently drafted, the provision applies equally to (1) a newly designated supervisor with no prior supervisory experience in the industry; (2) a lateral hire with decades of prior supervisory experience at similar-sized firms; (3) a longstanding employee of the member firm that is promoted as a designated supervisor; (4) a designated supervisor at a firm that conducts most of its business in-person; and (5) a designated supervisor at a firm in which nearly all personnel work 100% from home under off-site supervision. Given the vast differences between firms and their business models, as well as the situations in which someone may be newly designated as a supervisor at a particular firm, there is no clear investor protection benefit in applying a one-size fits all timeline. Ultimately, as currently drafted, this provision could disincentivize individuals from taking on supervisory roles or otherwise joining the industry. This result could disproportionately impact under-represented groups in the industry and consequently, negatively impact industry diversity.

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<sup>10</sup> “Each member shall establish and maintain supervisory procedures that must take into consideration, among other things, the firm’s size, organizational structure, scope of business activities, number and location of the firm’s offices, the nature and complexity of the products and services offered by the firm, the volume of business done, the number of associated persons assigned to a location, the disciplinary history of registered representatives or associated persons, and any indicators of irregularities or misconduct (*i.e.*, “red flags”), etc. The procedures established and reviews conducted must provide that the quality of supervision at remote locations is sufficient to ensure compliance with applicable securities laws and regulations and with FINRA rules. A member must be especially diligent in establishing procedures and conducting reasonable reviews with respect to a non-branch location where a registered representative engages in securities activities. Based on the factors outlined above, members may need to impose reasonably designed supervisory procedures for certain locations or may need to provide for more frequent reviews of certain locations.”

<sup>11</sup> See SR-FINRA-2022-021 (“FINRA adopted temporary Rule 3110.17 in late 2020 and the temporary rule has been extended twice since. Hence, as of June 2022, member firms have been able to conduct remote inspections for 18 months. FINRA staff considered findings from FINRA’s examination of member firms and their branch locations that took place in between 2018 and 2021. This preliminary review found no significant departures relative to pre-pandemic examination results.”).

### ***III. Simultaneous Consideration of the Proposal, Residential Supervisory Location Proposal, and Expiration of Rule 3110.17***

SIFMA encourages the SEC to consider the Proposal in conjunction with FINRA’s related proposal on the Remote Inspections Pilot Program and approve both simultaneously given their interconnectivity.<sup>12</sup> This coordination is key given that one of the core aspects of the pilot program is data collection on inspections that is segregated by and dependent on an offices’ classification as an OSJ, a supervisory branch office, a non-supervisory branch office, or a non-branch location.<sup>13</sup> As such, to avoid throwing off the results of the pilot program, members will need clear guidance on whether a particular residence needs to be classified as an OSJ or a non-branch Residential Supervisory Location.

In addition, the proposed pilot program is designed to provide an orderly transition from the temporary relief provided by Rule 3110.17. It would be ideal to simultaneously approve both proposals with an effective date on or before the December 31, 2022 sunset of Rule 3110.17. Any gaps between the two would result in significant regulatory uncertainty and operational burdens. If the SEC believes this timeline cannot be met, then SIFMA requests that the SEC consider extending Rule 3110.17 until the pilot and Residential Supervisory Locations proposals are approved and become effective. Any such extension should be granted with sufficient advance notice to provide firms with clarity on their regulatory obligations.

### ***IV. SIFMA Encourages A Continued Dialogue With The SEC, FINRA, And NASAA On Modernization Efforts***

SIFMA commends FINRA for recognizing that its rules can be modernized without sacrificing the paramount goal: investor protection, as demonstrated by the Proposal. The competitiveness and viability of the securities industry vis-a-vis other industries that offer greater workforce flexibility is at stake. We welcome a dialogue with the SEC, FINRA, the North American Securities Administrators Association (“NASAA”) and other stakeholders on how rules and regulations can adapt to the ever-changing landscape of the industry. We are especially supportive of the shifting focus from arbitrary location-based rules to a more risk-based approach. We believe that this Proposal is one step in the right direction.

As a marker for a future conversation, we do not believe that each location currently subject to the inspection requirement (whether it be one or three years) warrants inspection where it does not engage in activities that present material risk of misconduct or harm. For example, locations with permissively registered individuals; locations that are established solely for customer service or back office type functions where no sales activities are conducted; locations where the only supervisory activities carried out do not implicate the same level of risk as locations with conduct that requires further regulatory scrutiny; and investment bankers that don’t keep hard copy documents in their home offices and whom are often on the road. In line with our suggestions, inspections and branch office registration for that matter should only be mandatory for locations where firm personnel meet with customers, where the firm accepts or holds customer securities or funds, or any other locations that a firm determines after conducting a risk-based analysis (e.g., a location with personnel subject to heightened supervision). All other locations should

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<sup>12</sup> FINRA, *Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision)*, File No. SR-FINRA-2022-021, 87 Fed. Reg. 50144 (Aug. 15, 2022), <https://www.finra.org/sites/default/files/2022-07/sr-finra-2022-021.pdf>.

<sup>13</sup> See proposed rule 3110.18(f)(1) (“a member shall provide separate counts for OSJs, supervisory branch offices, non-supervisory branch offices, and non-branch locations...”).

qualify as non-branch locations for which members simply need to keep an address on file but not register or inspect.

In order to implement risk-based inspection scheduling, we recommend that FINRA consider future updates to remove the annual requirement of FINRA Rule 3110.12 and the FINRA Rule 3110.13 presumption that such locations require inspection at least every three years in favor of a risk-based schedule. Risk factors weighed by firms, such as business conducted, access to firm books and records, heightened supervision of certain persons, and access to firm capital, could be documented. This process would allow for greater flexibility in handling supervision of lower risk areas of firm business without increasing risk of customer harm and would significantly lower costs on firms as more employees increasingly work from alternative work locations. We also ask that any risk-based schedule should not have minimum requirements that exceed current minimum inspection schedule requirements.

## V. *Conclusion*

SIFMA appreciates the opportunity to comment on the Proposal. SIFMA applauds FINRA for its efforts towards modernizing the Supervision rule and believes the comments included in this letter are consistent with FINRA's efforts to update these rules to realize regulatory efficiencies and align the rules' costs and investor protection benefits.

Given that off-site supervision has been working well – nothing to the contrary has been expressed by regulators, we think it is prudent for the SEC to support FINRA's proposed rule relating to Residential Supervisory Locations. We appreciate you taking into consideration our comments and we look forward to engaging with you on this effort. If you have any questions or require further information with respect our comments, please do not hesitate to contact the undersigned or SIFMA's outside counsel, Marlon Q. Paz of Latham & Watkins LLP, at (202) 654-7101.

Very truly yours,

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