



**FINANCIAL  
SERVICES  
INSTITUTE**

VOICE OF INDEPENDENT  
FINANCIAL SERVICES  
FIRMS AND INDEPENDENT  
FINANCIAL ADVISORS

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

July 27, 2020

Vanessa Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

Re: File No. SR-FINRA-2020-019

Dear Secretary Countryman:

On July 7, 2020, the Securities and Exchange Commission (SEC) published a proposed rule change, submitted by the Financial Industry Regulatory, Inc. (FINRA) to the SEC on June 19, 2020, and invited public comment on FINRA's Proposed Rule Change to Temporarily Extend the Time to Complete Office Inspections Under FINRA Rule 3110 (Supervision).<sup>1</sup> FINRA proposed to adopt temporary Supplementary Material .16 under FINRA Rule 3110, in light of the operational challenges member firms are facing due to the outbreak of the coronavirus disease (Covid-19), which would extend the time by which member firms must complete their calendar year 2020 inspection obligations under Rule 3110(c) (Internal Inspections) to March 31, 2021.

The Financial Services Institute<sup>2</sup> (FSI) appreciates the opportunity to comment on this important proposal. FSI supports, and is appreciative of, the temporary relief FINRA proposes to provide member firms to complete 2020 inspection obligations, but believes that, in light of the ongoing and expanding health and safety challenges presented by Covid-19, completion of any inspection requirement where an on-site office visit is expected, is not realistic by March 31, 2020. On this issue, FSI encourages FINRA to take a more holistic approach to address the challenges presented by this unprecedented time to include consideration of the "backlog" of 2020 on-site inspections, and the resulting impact on 2021 inspections, as well as additional information and guidance on the use of virtual or remote inspections. As discussed in Section II below, the text of FINRA Rule 3110(c) – which does not state that an on-site office visit is required – provides flexibility for FINRA to issue guidance to the industry that modernizes inspection expectations to recognize the availability and current use of a variety of technology,

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<sup>1</sup> SEC, Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Temporarily Extend the Time To Complete Office Inspections Under FINRA Rule 3110 (Supervision), 85 FR 40713 (June 30, 2020), available at <https://www.finra.org/sites/default/files/2020-07/SR-FINRA-2020-019-nof-imm-eff.pdf>

<sup>2</sup> The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

especially in light of virtual working conditions. We believe the current circumstances are exactly those that necessitate the guidance anticipated and allowed by the SEC.

### **Background on FSI Members**

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are more than 160,000 independent financial advisors, which account for approximately 52.7 percent of all producing registered representatives.<sup>3</sup> These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).<sup>4</sup>

FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate \$48.3 billion of economic activity. This activity, in turn, supports 482,100 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly \$6.8 billion annually to federal, state, and local government taxes. FSI members account for approximately 8.4% of the total financial services industry contribution to U.S. economic activity.<sup>5</sup>

### **Discussion**

FSI appreciates the opportunity to comment on FINRA's Proposed Rule Change to Temporarily Extend the Time to Complete Office Inspections for calendar year 2020. While FSI supports FINRA's recognition that additional time is needed to complete on-site inspections for 2020 after the emergence of Covid-19 in March 2020, and resulting state health and safety initiatives that required firms to send home most, if not all, of their personnel, FSI believes the ongoing and expanding nature of the health emergency means that completion of 2020 inspections with an on-site component by March 31, 2021 will not be feasible. These concerns are discussed in greater detail below.

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<sup>3</sup> Cerulli Associates, Advisor Headcount 2016, on file with author.

<sup>4</sup> The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment adviser" or "advisor" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

<sup>5</sup> Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016).

## I. Temporary Relief During the Covid-19 Emergency

### A. Introduction

FSI members appreciate the temporary regulatory relief provided by both the SEC and FINRA because of certain necessary changes caused by the Covid-19 pandemic.<sup>6</sup> As the SEC and FINRA are aware, beginning in March 2020, most FINRA members had to send employees home from offices based on state issued orders and, also, to protect the health of firm personnel. Firms quickly shifted to operating under Business Continuity Plans (BCPs) while assisting clients through economic hardship and extreme market volatility. Overall, FSI members report that the transition to virtual work has gone smoothly and that members transitioned well to serving clients using technology such as email, phone, and video meetings to replace in-person interactions.

Similarly, firms adapted their supervisory functions and inspections for the virtual environment and have expanded on remote supervision of their businesses and remote inspections to be effective in the absence of the ability to be physically on-site where they may have otherwise. As firms adapted to the longer-than-initially-expected time operating under their BCPs, firms have responded to changing circumstances and have documented operational and supervisory changes that were necessary because of the working conditions caused by the pandemic. In fact, firms report that they are considering retaining certain operational and supervisory changes initiated as a result of the Covid-19 health emergency even after the health emergency lifts. Modifications are likely necessary given that increased reliance on remote work is a trend that many expect to continue, and clients have grown accustomed to the convenience of meeting their financial advisors by video meeting. Unfortunately, some four months after leaving firm offices, the Covid-19 crisis persists and, in many locations in the United States, has recently intensified with public health officials warning that the pandemic could worsen during the winter months leading to the proposed March 31, 2021 deadline.

### A. Practical Health and Safety Considerations for FSI Members

Based on their business models, FSI member firms tend to have a large number of geographically dispersed Offices of Supervisory Jurisdiction (OSJ) and branch offices. Dually registered financial advisors have offices in the communities where they serve clients, including suburbs and rural locations. As a result, compliance personnel conducting inspections often travel a considerable distance and cannot reach all necessary offices through a few concentrated trips. For example, one member has almost 1,400 offices covering 49 states across the country, including Alaska and Hawaii, while another has over 2,000. Under regular circumstances, with time and planning, member firms accomplish office visits by scheduling them throughout the calendar year.

This year, firms' plans were abruptly interrupted. In March 2020, when virtual work became necessary because of public safety measures required to combat the pandemic, firms had completed only a portion of scheduled on-site office inspections. For example, one firm that planned to conduct over 550 on-site inspections had completed approximately 70 when the pandemic struck, while another firm had remaining approximately 2,500 planned on-site visits when travel restrictions and other public health measures were put into place. Inspections have

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<sup>6</sup> <https://www.sec.gov/sec-coronavirus-covid-19-response> and <https://www.finra.org/rules-guidance/key-topics/covid-19>

continued, however, through remote and virtual means. The ability to “catch-up” on these on-site visits, and schedule and complete 2021 inspections, appears increasingly unlikely because of the ongoing nature of the public health emergency and resulting travel restrictions. One firm calculated the even if corporate travel was allowed by the beginning of 2021, it would have to examine approximately seven offices a day. This calculation does not factor extra time needed to manage issues and challenges associated with Covid-19 travel, such as a state where a planned inspector lives being added to another state’s 14-day quarantine requirement shortly before a scheduled inspection in that state. These types of travel and safety issues are outlined in more detail below.

Given the current Covid-19 conditions, in virtually all locations in the country, it is impossible to safely conduct on-site inspections.<sup>7</sup> As of July 18, 2020, the United States continues to see new case number records – with the highest number of cases recorded on July 17<sup>th</sup> of 77,000 cases per day followed by the second highest number recorded, on July 18<sup>th</sup>, with 71,000 cases per day.<sup>8</sup> Furthermore, personal health risks and public safety concerns are greatly amplified when travel is required. The concern and possible reality that one asymptomatic firm compliance professional could, for example, in an intensified effort to visit as many offices as possible during a concentrated period, become sick with coronavirus and infect people at multiple office locations is of great worry to FSI members. This would eliminate a compliance professional from working, even remotely, due to illness, and impede sickened financial advisors’ abilities to serve clients during a time when access to financial advice is vital. While FSI members take their compliance, supervisory, and inspection obligations seriously and want to prevent or correct issues detected through on-site office visits, no firm wants someone to become sick and potentially lose their life over business travel to fulfill an on-site inspection obligation. Firms must consider that they may have compliance personnel and financial advisors with pre-existing conditions. In addition, states are considering the effect that possible Covid-related lawsuits may have on businesses as they try to reopen and Congress is grappling with this same issue.<sup>9</sup> The current health and public safety realities are reflected in the practical and necessary approach that both the SEC and FINRA are currently taking to fulfill their regulatory responsibilities through both organizations’ exam programs – on-site exam visits are currently on hold and are happening remotely instead.

FSI members value their compliance staff and affiliated advisors greatly. The health and well-being of personnel is of utmost importance and, as everyone navigates many unknowns related to the long-term health effects of the Covid-19 infection, firms are respectful of the difficult personal decisions people are making about everyday tasks, including work in an office setting and travel. In a recent study conducted by a Stanford economist and published in late June 2020, 42 percent of the U.S. labor force is now working from home full-time, with another 33 percent not currently working, and the remaining 26 percent – mostly essential service workers – working on their business premises.<sup>10</sup> On travel, the CDC states: “COVID-19 cases and deaths have been reported in all 50 states, and the situation is constantly changing. Because travel increases your chances of getting infected and spreading COVID-19, **staying home is the best**

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<sup>7</sup> The scope of the pandemic has grown since the time that FINRA, on June 19, 2020, submitted its proposed rule change to extend the time to complete 2020 on-site inspections to March 31, 2020.

<sup>8</sup> <https://www.wsj.com/articles/coronavirus-latest-news-07-18-2020-11595076959?mod=searchresults&page=1&pos=2>

<sup>9</sup> *There’s a fight brewing over whether companies are responsible when workers get coronavirus*, (June 19, 2020) available at <https://www.cnbc.com/2020/06/19/coronavirus-lawsuits-businesses-and-labor-groups-clash-over-liability.html>

<sup>10</sup> *Stanford research provides a snapshot of a new working-from-home economy* (June 29, 2020) available at <https://news.stanford.edu/2020/06/29/snapshot-new-working-home-economy/>

**way to protect yourself and others from getting sick.”<sup>11</sup>** (emphasis in original). Given the virus’ resurgence, currently at least 17 states have in place certain 14-day quarantine mandates on travelers entering their state, with some counties and municipalities also placing restrictions on travelers.<sup>12</sup> Some states also require proof of a negative Covid-19 test prior to entering the state.<sup>13</sup>

Simply put, many people are not currently comfortable with working in an office setting nor with travel (especially air travel), and travel restrictions across states are complex and subject to rapid change. This not only creates challenges in scheduling on-site visits to complete them by March 31, 2021, but forcing personnel to travel, and to accept visits from those traveling, especially by air from another state, is not a position that most FSI members feel comfortable with at this stage in the pandemic. All indications are that these challenges will continue well into 2021, particularly during the cold winter months. It is not realistic, based on current trends, to plan or expect Fall and Winter travel to improve and, for example, to rely on scheduled on-site visits during that time in order to meet the March 31, 2021 deadline. In fact, many scientists and health experts expect that combatting regular seasonal flu alongside Covid-19 will present considerable challenges.<sup>14</sup> Similarly, firms cannot expect that a vaccine will be ready and available to the public in time to safely allow completion of on-site exams by March 31, 2021.

B. FSI Members’ Ability to Effectively Supervise and Conduct Inspections Required Under FINRA 3110(c) While Operating Virtually

FSI members have shifted supervisory systems and inspection functions to operate in the remote environment. While many firms, even prior to the pandemic, used technology to exchange and review many aspects of their business as part of a reasonable supervisory system, firms have optimized and expanded on these capabilities. For inspections, an on-site office visit is only a portion of the work that goes into the overall inspection process. Most firms, for example, already used remote testing and electronic review of firm books and records as part of their inspection program.

Current remote or virtual inspections continue to leverage technology to complete, through email, document review, use of secure websites to obtain scanned documents, phone, and video meetings, many aspects of inspections once done on-site. With more firm records maintained electrotonically, it has made review and identification of any potential “red flags” or discrepancies just as detectable as when more business was done in-person, in office settings. Firms have used video conferencing to conduct interviews, and, in some cases, can inspect a physical location with a video tour. For example, to review for outside business activities (OBA), firms have a variety of virtual tools available. In general, compliance professionals report that in their experience review of bank/credit card statements and internet research, such as using “google,” all of which can be done without an on-site inspection, have a higher probability of uncovering an OBA than through an on-site office visit.<sup>15</sup> Some firms have employed (or may

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<sup>11</sup> <https://www.cdc.gov/coronavirus/2019-ncov/travelers/travel-in-the-us.html>

<sup>12</sup> *Thinking of Traveling in the U.S.? These States Have Travel Restrictions*, NYT (July 10, 2020) available at <https://www.nytimes.com/2020/07/10/travel/state-travel-restrictions.html>

<sup>13</sup> See *id.*

<sup>14</sup> *CDC director warns second wave of coronavirus is likely to be even more devastating*, Wash Post (Apr. 21, 2020) available at <https://www.washingtonpost.com/health/2020/04/21/coronavirus-secondwave-cdcdirector/>

<sup>15</sup> While on-site inspection review areas, such as signage, control of non-public client information (e.g., locked cabinets, shred bins), could, for example, be covered with use of video tours, with many offices closed and/or not permitting on-site client meetings, these risks are largely mitigated.

consider employing) software to remotely inspect computers (similar to software used by many IT departments to support users), which could identify outside business email accounts, emails or documents that might evidence an OBA. Any emails, documents, or results from a “google” search can then be used to follow-up with personnel by video interview.

In addition, many firms have also worked to prioritize, based on risk criteria, on-site visits previously planned to be prepared to complete any in-person visits of certain offices first when they are safely able to do so, recognizing that changes in virus spread might necessitate canceling or further postponing visits if virus numbers and so-called “hot spots” increase. In addition, FSI members engaged in compliance and supervision functions have been sharing “best practices” and strategies to navigate the rapid (and now prolonged shift) to supervision and inspections in the virtual world.

## **II. FINRA Rule 3110(c) Provides Flexibility to Address this Public Health Crisis without the Necessity of Extensive Rulemaking**

### **A. Introduction**

The language of FINRA Rule 3110 and, subpart (c) in particular, provides sufficient flexibility to enable firms to establish reasonable supervisory systems and processes for shifting environments. As firms navigate Covid-19, a potentially longer-term shift to a more virtual environment, and technological enhancements and capabilities, including surveillance tools associated with machine learning technologies, FINRA’s supervision and inspection rules are well-drafted to accommodate these types of changing environments given that, at their core, the rules require a “reasonable” supervisory system. FSI understands that FINRA’s rules specifically prescribe a calendar year inspection, which necessitates FINRA’s proposal for temporary relief to extend the time period for 2020 inspections to the proposed March 31, 2021 date. FSI encourages FINRA to continue consideration of what constitutes a reasonably designed inspection considering technology advances as well as the changing Covid (and possible post-Covid) workplace.<sup>16</sup> FSI applauds FINRA for announcing that it is undertaking this type of review.<sup>17</sup>

### **B. FINRA Rule 3110(c) and Related Interpretation**

FINRA Rule 3110(c)(1), on Internal Inspections, states: “Each member shall conduct a review, at least annually (on a calendar-year basis), of the businesses in which it engages. The review shall be reasonably designed to assist the member in detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations, and with applicable FINRA rules. Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses. Each member shall also retain a written record of the date upon which each review and inspection is conducted.”

Firm compliance personnel traditionally travel on-site while conducting annual inspections based, in part, on FINRA and SEC interpretation, now nearly a decade old, which indicates that there must be an on-site component to certain office inspections, although the rule itself does not

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<sup>16</sup> *FINRA May Modify Rulebook, Supervision in Light of Virus*, ThinkAdvisor (July 16, 2020), available at <https://www-thinkadvisor-com.cdn.ampproject.org/c/s/www.thinkadvisor.com/2020/07/16/finra-may-modify-rulebook-supervision-in-light-of-virus/?amp=1>

<sup>17</sup> See *id.*

specifically use the term “on-site.”<sup>18</sup> Depending on the nature of a firm’s business and that of certain office locations, firms may find that on-site visits are a critical part of conducting a review “reasonably designed to assist the member in detecting and preventing violations of, and achieving compliance with” securities laws, rules, and regulations.<sup>19</sup> Other firms may find that, at least for certain office locations, a reasonably designed inspection could occur with a remote annual inspection as opposed to an on-site inspection. As FINRA, and the industry, evolves and learns based on this Covid-era that has, to some degree or another, required remote work, we support FINRA’s efforts to consider the role and necessity of guidance requiring on-site annual inspections under this rule. We recognize that FINRA has, in the past, reviewed this aspect of the rule and, in 2017, requested comment on its proposal to amend FINRA Rule 3110 (supervision rules) to allow for remote inspections of certain, qualified offices.<sup>20</sup> We look forward to continuing to participate in the dialogue with FINRA and the SEC on FINRA Rule 3110 and, in particular, inspection requirements.

C. Holistic Regulatory Guidance and Relief is Needed to Address 2020 Annual Inspections and the Impending Inspection Backlog for On-site Office Visits

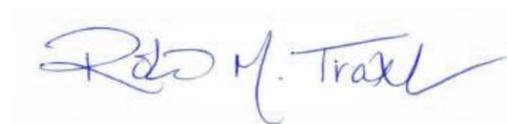
In the interim, for the reasons outlined above, we reiterate that completion of on-site office visits in connection with 2020 inspections are not feasible by March 31, 2021. As discussed above, the interruption caused by Covid-19 in the first quarter of 2020 has a ripple impact for all of 2020 that will continue well into 2021 (with the potential to effect 2021 firm inspections as well). Additional regulatory relief to address this inspection backlog is necessary and could include a range of regulatory relief from on-site inspection waiver for 2020, to combining annual regulatory requirements for 2020 and 2021 to, more broadly, issuing guidance that remote or virtual inspections can satisfy FINRA Rule 3110(c).

**Conclusion**

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with the SEC and FINRA on this and other important regulatory efforts.

Thank you for considering FSI’s comments. Should you have any questions, please contact me at (202) 393-0022.

Respectfully submitted,



Senior Vice President, Policy & Deputy General Counsel

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<sup>18</sup> Branch Office Inspections: FINRA and the SEC Issue Joint Guidance on Effective Policies and Procedures for Broker-Dealer Branch Inspections, FINRA Reg. Notice 11-54 (Nov. 2011) (stating “[a] broker-dealer must conduct **on-site** inspections of each of its office locations . . . at least annually” (emphasis added), available at <https://www.finra.org/sites/default/files/NoticeDocument/p125204.pdf>

<sup>19</sup> FINRA Rule 3110(c).

<sup>20</sup> Remote Branch Office Inspections, FINRA Reg. Notice 17-38 (Nov. 13, 2017), available at [https://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory-Notice-17-38.pdf](https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-38.pdf)