



PUBLIC INVESTORS ADVOCATE BAR ASSOCIATION

1225 West Main Street, Suite 126 | Norman, OK 73069
Toll Free (888) 621-7484 | Fax (405) 360-2063
www.piaba.org

August 23, 2022

Via Email Only @ rule-comments@sec.gov

Vanessa Countryman
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: SR-FINRA-2022-019 – Proposed Rule Change to Adopt New Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110

Dear Ms. Countryman:

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in disputes with the securities industry. Since its formation in 1990, PIABA has promoted the interests of the public investor in all forums where securities and commodities disputes are heard, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by the Financial Industry Regulatory Authority ("FINRA") relating to both investor protection and disclosure.

Pursuant to Rule of Practice 192(a) of the Securities and Exchange Commission ("SEC" or "Commission"), PIABA submits this comment to the SEC concerning FINRA's above-captioned recent filing, a proposed rule change to amend FINRA Rule 3110 (Supervision). FINRA proposes adding new Supplementary Material as section .19 to Rule 3110 (3110.19 - Residential Supervisory Location). The proposed amendment would allow a home office to be considered a residential supervisory location and creates rules and procedures for the supervision of same.

PIABA urges the Commission to reject the proposed amendment.

The Exigencies of the Pandemic Should Not Lead to Permanent Weakening of Supervisory Structures

As a result of the COVID-19 pandemic, regulators eased regulatory requirements to accommodate brokerage firm employees working from home. This effort included the introduction of new technologies to permit remote supervision. By way of this proposal, FINRA appears to be adapting to a new, post-pandemic "blended workforce" model, one in which employees work at both traditional offices as well as in their homes. FINRA has noted that "technological advances in surveillance and monitoring capabilities" have enabled greater "workplace flexibility."¹ FINRA thus

¹ Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change To Adopt Supplementary Material .19 (Residential Supervisory Location) Under FINRA Rule 3110 (Supervision), 87 Fed. Reg.

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considers this rule change proposal to be a reassessment of “the manner in which firms may effectively and efficiently carry out their supervisory responsibilities considering evolving business models and practices, advances in technology, and regulatory benefits.”²

In its proposal, FINRA argues that classifying some private residences as “non-branch” locations, “aligns” with procedures already in place (with certain exclusions) for non-traditional methods of supervision.³ FINRA further argues, unconvincingly, that the elevation of private residences to non-branch status “will not result in a loss of the important regulatory information that the rules were designed, in part, to provide regarding the locations or associated persons.”

Under the FINRA proposal, the private residential (non-branch) locations would be subject to limitations including but not limited to: 1) that only one associated person can conduct business at the location; 2) that the location is not held out to the public as an office (and that the associated person cannot meet with clients or prospects there); 3) that no customer funds or securities are handled there; 4) that the associated person is assigned to a specific branch office; 5) that all electronic communications are made through the member firm’s electronic data systems; and 6) that typical books and records must be maintained as is customary for the brokerage industry. It should be noted, FINRA has pointed out that, once a home office has been designated a “residential supervisory location,” inspections would be required on a regular periodic schedule (likely once every three years, as opposed to annually), as is required of other more traditional supervisory branch offices.

PIABA submits this comment because the bar association believes the amendment runs counter to FINRA’s stated objective of investor protection. While it is understood that FINRA is attempting to change with the increased use of virtual technology, it leaves considerable opportunity for brokers working from home to skirt the rules and harm investors. As discussed below, the existing supervisory structure regarding remote offices commonly leads to rogue brokers’ and advisors’ poor conduct continuing unmolested for extended periods of time. It would be ill advised to further weaken an already porous supervisory structure.

As the SEC considers FINRA’s proposal, we ask that the Commission staff consider numerous past enforcement cases from both FINRA and the SEC relating to inadequate supervision of remote offices. One such case is *In the Matter of Royal Alliance Associates, Inc.*, Release No. 38174, 63 SEC Docket No. 1606 (Jan. 15, 1997). In this case, the SEC took issue with Royal Alliance’s practice of performing announced audits on “small dispersed offices” beyond the “direct aegis of the firm”:

...Royal Alliance operates 1,500 offices with 2,700 registered representatives. Some 49 of these are one-person Offices. Here, Royal Alliance’s failure to scrutinize adequately the securities-related business of its registered representatives, which were conducted beyond the direct aegis of the firm, was a certain recipe for trouble. Further, Royal Alliance’s practice of conducting a pre-announced compliance examination only once a year was inadequate to satisfy its supervisory obligations.

* * *

Nevertheless, such arrangements necessarily entail greater supervisory challenges and the Commission requires firms organized in such a fashion, and individual supervisors at those firms, to meet the same high standards of supervision as at more traditionally organized firms.

The SEC continued to recognize this problem in another matter, *In the Matter of 1st Discount Brokerage, Inc.*, Release No. 66212A, Admin. Proc. File No. 3-14710 (Jan. 23, 2012). Therein, the SEC opined that firms that have an independent broker model require greater supervision than that of a traditional wire house brokerage firm. The lack

47249 (Tuesday, August 2, 2022) (notice of proposing rule change Proposed Rule Change To Adopt Supplementary Material .19 (Residential Supervisory Location) Under FINRA Rule 3110 (Supervision)).

² *Id.*

³ *Id.* at 47255.

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of unannounced audits for a far-away broker with no one looking over their shoulder was wholly deficient. The firm's failure to adequately supervise the broker's conduct resulted in enabling the broker to conduct a nearly \$9 million Ponzi scheme.

Other regulatory actions involving brokers "selling away" or running Ponzi schemes from residential or remote (often one-broker) offices are too plentiful to count. For a few examples: *In re Lawrence John Fawcett, Jr.*, FINRA No. 2017056329801 (operating from home); *see also Hailey v. Westpark Capital, Inc.*, FINRA Arb No. 20-00320 (detailing the lack of sufficient supervision of Fawcett's home office); *In re Jerry Irvin Chancy*, FINRA No. 2014043629801 (operating from home), *In re Mark Lewton Hopkins*, FINRA No. 2018060968101 (operating from an office on a golf course owned by the broker); *In re Malcolm Segal*, FINRA No. 2014041990901 (home office); *In re Robert Van Zandt*, FINRA No. 2011027577001; *In re Nevin Gillette*, FINRA No. 2006007067401; *In re Charles Caleb Fackrell*, FINRA No. 2014043705201; *In re Thomas H. Laws*, FINRA No. 2019061095601; *In re Brian Royster*, FINRA No. 2017052882601; *In re Michael James Blake*, FINRA No. 2010021710501; *In re Murray Todd Petersen*, FINRA No. 2019064432901; *In the Matter of Rebecca Engle*, SEC Admin. Release 34-75127 (June 9, 2015); *In the Matter of Brian Schuster*, SEC Admin. Release 34-75128 (June 9, 2015); *In the Matter of Larry Dearman Sr.*, SEC Release No. 75292 (June 24, 2015); *In the Matter of Levi D. Lindemann*, SEC Release No. 77696 (Apr. 22, 2016); and *In the Matter of Securities America Advisors, Inc.*, SEC Release No. 94995 (May 26, 2022) (regarding a failure to supervise Hector May, who ran a \$8 million Ponzi scheme).

This partial history of enforcement cases indicates member firms have been and remain unable or unwilling to effectively supervise remote offices. While the pandemic brought technological advancements, the same cannot be assumed for broker-dealer supervisory and compliance cultures.

FINRA's rule proposal includes a provision that the broker would not be allowed to visit with clients at their remote office. Our members, industry participants, and the regulators, know all too well that a dishonest broker cannot be trusted to follow the rules, especially when there is no real oversight. Likewise, other aspects of the proposed rules do not inspire confidence. A review of all electronic communications that are made through the member firm's electronic data systems would only be sufficient if the rules governing how firms are required to adequately review these emails are strengthened. Often, firms only review a small *sampling* of electronic correspondence. Our members have seen numerous cases where the broker engaged in secretly selling unauthorized investments *was openly discussing* the unlawful conduct through their firm-approved email address, but the firm did not detect it for years (or ever) because the firm did not have adequate systems in place to monitor and catch the emails.

Any provision that weakens the supervisory rules as they relate to inspections of home or remote offices is unacceptable and will lead to more harmed investors. These proposed rules will provide additional opportunities for a broker to engage in fraudulent conduct without a supervisor or auditor adequately supervising the broker's conduct. If anything, FINRA should require firms to develop and implement more unannounced inspections, improved electronic communications surveillance, and increased monitoring for selling-away activity as remote offices and virtual technology become more prevalent.

PIABA thanks the Commission and FINRA for the opportunity to comment on this proposal.

Very Truly Yours,



Michael S. Edmiston