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July 25, 2023

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. SR-FINRA-2023-006 – Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision)

Dear Ms. Countryman:

The Financial Industry Regulatory Authority ("FINRA") submits this letter in response to comments received by the Securities and Exchange Commission ("SEC" or "Commission") to a proposal to amend FINRA Rule 3110 to add new Supplementary Material .19 (Residential Supervisory Location).[1] The Initial Proposal would align 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 to treat a private residence at which an associated person engages in specified supervisory activities as a non-branch location, subject to specified safeguards and limitations. The Initial Proposal is largely similar to File No. SR-FINRA-2022-019, which FINRA withdrew to consider whether modifications and clarifications to that proposed rule change would be appropriate in response to the concerns raised by commenters.[2]

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1 See Securities Exchange Act Release No. 97237 (March 31, 2023), 88 FR 20568 (April 6, 2023) (Notice of Filing of File No. SR-FINRA-2023-006) (the "Initial Proposal").

2 See Withdrawal of File No. SR-FINRA-2022-019 ("2022 RSL Rule Filing"), https://www.finra.org/sites/default/files/2023-03/sr-finra-2022-019-withdrawal.pdf.

The Commission published the Initial Proposal for public comment in the Federal Register on April 6, 2023, and the comment period closed on April 27, 2023.[3] The Commission received 13 comment letters in response to the Initial Proposal.[4] In general, the commenters support the overall intent of the Initial Proposal, but some raise concerns with aspects of the proposed conditions and ineligibility criteria.[5] Two commenters, while supporting aspects of the proposed ineligibility criteria, express concern that the Initial Proposal would not adequately ensure effective supervision and recommend further changes.[6]

On May 16, 2023, FINRA consented to an extension of the time period for SEC action on the Initial Proposal to July 5, 2023.[7] On July 3, 2023, FINRA filed Partial Amendment No. 1, which proposed changes to the Initial Proposal informed by the comments.[8] On July 11, 2023, the SEC published a Notice of Filing of Amendment No. 1 and Order Instituting Proceedings, which began a second comment period that expires on August 1, 2023 and a rebuttal comment period that expires on August 15, 2023.[9]

In light of the comments received in response to the Initial Proposal, FINRA proposed to amend the Initial Proposal as set forth in Partial Amendment No. 1 to:

- Adjust the location ineligibility criteria pertaining to an associated person with less than one year of supervisory experience to also be satisfied by experience at a member firm's affiliate or subsidiary that is registered as a broker-dealer or investment adviser;

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3 See note 1, supra.

4 See Attachment A for the list of commenters.

5 See CAI, Cetera, Citigroup, FSI, LPL, NASAA, PIABA and SIFMA.

6 See NASAA and PIABA.

7 See Letter from Sarah Kwak, Associate General Counsel, FINRA, to Daniel Fisher, Division of Trading and Markets, SEC, dated May 16, 2023.

8 See Securities Exchange Act Release No. 97839 (July 5, 2023), 88 FR 44173 (July 11, 2023) (Notice of Filing of Amendment No. 1 and Order Instituting Proceedings To Determine Whether To Approve or Disapprove File No. SR-FINRA-2023-006) ("Partial Amendment"). In such Partial Amendment, FINRA noted that it anticipated submitting by separate letter its response to comments on the proposed rule change.

9 See note 8, supra.

- Clarify the scope of the location ineligibility criteria pertaining to an associated person who is the subject of an investigation or proceeding by a regulator relating to an allegation of a failure to supervise by defining those terms as they are defined in Form U4 (Uniform Application for Securities Industry Registration or Transfer Registration) and address the applicability of the proposed exclusion when an investigation has remained pending for a period of time; and

- Require a firm to conduct and document a risk assessment for each office or location before designating such office or location as a Residential Supervisory Location (or "RSL"), including a non-exhaustive list of factors to consider as part of that risk assessment.

Below, FINRA discusses the comments on the Initial Proposal, including those that led to the Partial Amendment.

Conditions for Designation as a Residential Supervisory Location (RSL) (Proposed Rule 3110.19(a))

As explained in the Initial Proposal, many of the proposed conditions for RSL designation are based on those used for the existing residential exclusions to the branch office definition, including the proposed condition in Rule 3110.19(a)(1) pertaining to limiting RSL designation to a private residence at which only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family conduct business at the location. While CAI supports the Initial Proposal, it reiterates its view conveyed in its previous comment letter that there is no meaningful investor protection benefit in including as an RSL condition a criterion that "only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct business at the location," and references several scenarios relating to this proposed condition that it believes unnecessarily limits the RSL designation.[10]

FINRA appreciates this concern, but notes that this proposed condition in Rule 3110.19(a)(1) is intended to align with one of several conditions to the current residential exclusions to the branch office definition under Rule 3110(f)(2)(A)(ii)a. Moreover, this condition is derived from SEA Rule 17a-4(l), which provides that a broker-dealer is not required to maintain records at an office that is a private residence "where only one associated person (or multiple associated persons who reside at that location and are members of the same immediate family) regularly conducts business," among other

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[10] See Letter from Clifford Kirsch & Eric Arnold, Eversheds Sutherland (US) LLP on behalf of the Committee of Annuity Insurers, to Secretary, SEC, dated August 23, 2022, submitted in response to the 2022 RSL Rule Filing, https://www.sec.gov/comments/sr-finra-2022-019/srfinra2022019.htm.

conditions.[11] For these reasons, FINRA declines to adjust proposed Rule 3110.19(a)(1). However, FINRA will consider comments related to this issue in connection with future initiatives to consider the OSJ and branch office definitions more broadly, and FINRA will consider providing additional clarity, as appropriate.[12]

Location Ineligibility Criteria (Proposed Rule 3110.19(c))

The Initial Proposal would set forth several location-level criteria that would preclude a private residence where supervisory activities are occurring from being designated as an RSL. These ineligibility criteria would include, among others, an associated person at the office or location: (1) who has less than one year of direct supervisory experience with the member firm; (2) is subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA or a state regulatory agency; and (3) is alleged to have failed to reasonably supervise another person subject to their supervision. Ten commenters share their views on these proposed exclusions.[13]

- *One-Year Supervisory Experience with the Member (Proposed Rule 3110.19(c)(1))*

Proposed Rule 3110.19(c)(1) would provide that an office or location would be ineligible as an RSL where one or more associated persons at such office or location designated as a supervisor has less than one year of direct supervisory experience with the member. As explained in the Initial Proposal, this proposed exclusion is intended to address the concern that an associated person does not have the requisite tenure at the

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11 See 17 CFR 240.17a-4. See generally Notice to Members 01-80 (December 2001) (describing amendments to the SEC Books and Records Rules).

12 FINRA notes that the term "immediate family" is not defined under Rule 3110(f)(2), but it is defined in other FINRA rules. See, e.g., paragraph (c) under FINRA Rule 3241 (Registered Person Being Named a Customer's Beneficiary or Holding a Position of Trust for a Customer), defining "immediate family" to mean "parents, grandparents, mother-in-law or father-in-law, spouse or domestic partner, brother or sister, brother-in-law or sister-in-law, son-in law or daughter-in-law, children, grandchildren, cousin, aunt or uncle, or niece or nephew, and any other person who resides in the same household as the registered person and the registered person financially supports, directly or indirectly, to a material extent. The term includes step and adoptive relationships."

13 See ASA, CAI, Cetera, Citigroup, Davenport, FSI, LPL, NASAA, PIABA and SIFMA.

member firm to develop experience with the firm's systems, people, products, and overall compliance culture.[14]

Six commenters raise concerns about this proposed provision, stating that the timing requirement is arbitrary and overbroad, and would adversely impact hiring efforts.[15] Focusing on the proposed language that calls for "supervisory experience 'with the member,'" CAI states that the proposed exclusion would impose a "chilling effect on the transfer of experienced supervisory personnel from one broker-dealer to another broker-dealer." Cetera states that the one-year timeframe is arbitrary, noting that an individual who successfully passes a qualification examination may begin performing the licensed functions without delay. Three commenters suggest alternatives to address the concerns about an associated person's supervisory experience. FSI recommends a three or six-month period during which an associated person can gain the requisite experience with the firm's systems, people, products, and overall compliance culture. ASA and LPL suggest that instead of excluding a newly hired supervisor's private residence from otherwise qualifying as an RSL, that the residence undergo an inspection within the first year of RSL designation.

As explained in the Partial Amendment, in consideration of the comments about the potential adverse impacts such conditions could have on hiring efforts, including the transfer of supervisory experience from one broker-dealer to another, FINRA is proposing to amend proposed Rule 3110.19(c)(1) to permit the one-year supervisory experience minimum to be satisfied by also counting supervisory experience accrued at an affiliate or subsidiary of the member firm that is registered as a broker-dealer or investment adviser. Thus, an associated person with six months of supervisory experience at a member firm's affiliate or subsidiary that is registered as a broker-dealer or investment adviser, who then subsequently becomes associated with the member firm in a supervisory capacity, would be able to carry forward the accrued supervisory experience to the member firm for purposes of having their location considered as an eligible RSL, subject to the other specified terms of proposed Rule 3110.19. FINRA believes that the proposed adjustment would reflect a more balanced approach to addressing the concerns about hiring efforts and an associated person's minimum level of experience as a supervisor with a particular member by recognizing that such entities may share systems and have similar compliance cultures to meet their obligations under the federal securities laws.

- *Heightened Supervisory Plan (Proposed Rule 3110.19(c)(3))*

Proposed Rule 3110.19(c)(3) would provide that a location would be ineligible as an RSL where one or more associated persons at such location is subject to a mandatory

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14 See also Initial Proposal, Exhibit 2b.

15 See ASA, CAI, Cetera, FSI, LPL and SIFMA.

heightened supervisory plan under the rules of the SEC, FINRA or state regulatory agency. NASAA has repeated its recommendation to expand this proposed ineligibility condition to include heightened supervisory plans imposed by the member, stating that such plans raise the same concerns as regulator-mandated plans. NASAA recommends that proposed Rule 3110.19(c)(3) should be revised to include a heightened supervisory plan mandated under the rules of the SEC, FINRA or state regulatory agency "or heightened supervision under a plan established by the member in connection with or in response to any such regulator's recommendation or finding."

FINRA reaffirms its response to NASAA's comment to the 2022 RSL Rule Filing that "a firm should routinely evaluate its supervisory system to ensure it is appropriately tailored to the firm's business (citation omitted). Such an evaluation may prompt a firm, out of an abundance of caution and independent of specific regulatory requirements or mandates, to undertake additional supervisory measures, including voluntarily imposing a heightened supervisory plan."[16] FINRA declines to expand the ineligibility criteria to include such voluntary heightened supervisory plans because FINRA believes what constitutes a voluntary heightened supervisory plan is subjective and, moreover, could act to disincentivize firms from imposing tailored or more specific supervisory controls if the result was RSL ineligibility. However, FINRA agrees that there is value in considering heightened supervision as a risk factor. To strike an appropriate balance between a firm's decision to impose its own heightened supervisory plan and NASAA's concern, FINRA is proposing to account for nonmandatory heightened supervision generally under proposed new paragraph (e) (Risk Assessment) to proposed Rule 3110.19, as an express risk factor to be considered as described further below.

- *Allegation of Failure to Supervise (Proposed Rule 3110.19(c)(6))*

Proposed Rule 3110.19(c)(6) would provide that a location would be ineligible as an RSL where 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, an SRO, 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 specified provisions, including any state law pertaining to the regulation of securities or any of the rules of FINRA. Three commenters support this proposed exclusion.[17] While supportive, PIABA believes that the proposed exclusion should be expanded to account for associated persons who have been the subject of multiple customer complaints, consumer-initiated, investment-related arbitrations or civil litigation. In response to this comment, and as described in the Partial Amendment,

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16 See Initial Proposal, Exhibit 2c.

17 See Davenport, NASAA and PIABA.

FINRA is proposing to account for customer complaints in the newly proposed Rule 3110.19(e), which would require firms to conduct and document a risk assessment and expressly include consideration of customer complaints, taking into account the volume and nature of the complaints. FINRA emphasizes that the enumerated list of factors is non-exhaustive. While consumer-initiated, investment-related arbitration or civil litigation is not listed as one of the enumerated factors under proposed Rule 3110.19(e), FINRA agrees that the presence of such arbitration or civil litigation would be a factor for a firm to consider as part of the risk assessment.

Four commenters, however, express concerns with that the proposed exclusion is overly broad and vague.[18] They assert collectively that: allegations against an associated person are commonly inaccurate or lacking in detail to be sufficient to assess the associated person's culpability or involvement; allegations raise issues of basic fairness because an office or location could lose its RSL designation by one state's allegation without adjudication;[19] it is difficult to know when a state investigation officially opens and when it closes, and it may take years to officially close;[20] and as a practical matter, firms would encounter challenges in tracking this proposed exclusion because of the lack of uniformity among standards at the state level for opening an investigation, and more generally, Form U4 does not expressly require disclosure of state investigations alleging a failure to supervise.[21] Cetera recommends that the proposed exclusion be more limited and specific to require an agency intending to proceed with an enforcement action against the associated person for failure to supervise to provide such person with written notification akin to a "Wells" notice.[22] To address the practical challenges and concerns over basic fairness, SIFMA and Citigroup recommend that a state investigation for a failure to supervise should be considered in the context of a firm's existing obligations under Rule 3110 to maintain a reasonably designed supervisory system and to conduct an appropriate risk assessment.

In consideration of these comments, FINRA is proposing to amend proposed Rule 3110.19(c)(6) to clarify the scope of applicable regulatory investigations and proceedings by defining the terms as those terms are defined in Form U4, and adding the word "expressly" to reduce ambiguity regarding the nature of the allegations. In addition, FINRA is proposing to specify the applicability of the proposed exclusion when an Investigation (as such term would be defined) has been pending for a period of time. As

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18 See ASA, Cetera, Citigroup and SIFMA.

19 See Cetera and SIFMA.

20 See ASA, Cetera and SIFMA.

21 See ASA, Citigroup and SIFMA.

22 See generally Regulatory Notice 09-17 (March 2009) (describing, among other things, the Wells process, including the Wells notice).

amended, proposed Rule 3110.19(c)(6) would provide that an office or location would be ineligible for RSL designation if one or more associated persons at such office or location has been notified in writing that such person is now subject to any Investigation[23] or Proceeding,[24] as such terms are defined in Form U4's Explanation of Terms, by the SEC, a self-regulatory organization, including FINRA, or state securities commission (or agency or office performing like functions) (each, a "Regulator") expressly alleging that they have failed to reasonably supervise another person subject to their supervision, with a view to preventing the violation of the specified provisions. FINRA notes that the component of the proposed provisions—"'expressly' alleging they have failed to reasonably supervise another person subject to their supervision"—would be satisfied where a Regulator's written notification to an associated person describes circumstances and other allegations that could be reasonably construed to relate to a failure to reasonably supervise another individual under the associated person's supervision. In addition, as amended, proposed Rule 3110.19(c)(6) would include a temporal element to provide that such office or location may be designated or redesignated as an RSL, subject to the requirements of proposed Rule 3110.19, upon the earlier of: (1) the member's receipt of written notification from the applicable Regulator that such Investigation has concluded without further action; or (2) one year from the date of the last communication from such Regulator relating to such Investigation. FINRA believes using the definitions from Form U4 provides

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23 Form U4 Explanation of Terms defines "Investigation" as: "Includes: (a) grand jury investigations; (b) U.S. Securities and Exchange Commission investigations after the "Wells" notice has been given; (c) FINRA. [sic] investigations after the "Wells" notice has been given or after a person associated with a member, as defined by The FINRA By-Laws, has been advised by the staff that it intends to recommend formal disciplinary action; (d) NYSE Regulation investigations after the "Wells" notice has been given or after a person over whom NYSE Regulation has jurisdiction, as defined in the applicable rules, has been advised by NYSE Regulation that it intends to recommend formal disciplinary action; (e) formal investigations by other SROs; or (f) actions or procedures designated as investigations by jurisdictions. The term investigation does not include subpoenas, preliminary or routine regulatory inquiries or requests for information, deficiency letters, "blue sheet" requests or other trading questionnaires, or examinations."

24 Form U4 Explanation of Terms defines "Proceeding" as: "A formal administrative or civil action initiated by a governmental agency, self-regulatory organization or a foreign financial regulatory authority; a felony criminal indictment or information (or equivalent formal charge), or a misdemeanor criminal information (or equivalent formal charge), but does not include an arrest or similar charge effected in the absence of a formal criminal indictment or information (or equivalent formal charge). NOTE: Investment-related civil litigation, other than that specified above, is reportable under Question 14H on Form U4. An investigation is reportable under Question 14G on Form U4."

consistency and clarity not only with respect to the scope of applicable events subject to the ineligibility criteria, but also regarding when some events "begin" (e.g., after the "Wells" notice has been given).[25] In addition, FINRA notes that the presence of the events specified under the proposed exclusion may signal the need for a firm to conduct more frequent inspections of the office or location. FINRA further believes that the proposed temporal element would minimize commenters' concerns that unadjudicated allegations would form the basis of a location's permanent exclusion as an RSL.

List of RSLs (Proposed Rule 3110.19(d))

Under proposed Rule 3110.19(d), a member that elects to designate any office or location of the member as an RSL would be required to provide FINRA with a current list of all locations designated as RSLs by the 15th day of the month following each calendar quarter in the manner and format (e.g., through an electronic process or such other process) as FINRA may prescribe. Davenport supports the proposed provision without qualification. FSI and Nationwide offer similar recommendations to make the process for firms to provide a list to FINRA more efficient. To reduce regulatory duplication, FSI recommends using the established branch office registration and designation framework for reporting and provide a designation specifically for RSLs. Nationwide recommends a more automated process for providing a list of RSLs to FINRA through, for example, a separate form to allow firms to link the registered person to an RSL instead of the OSJ to show the "supervisory hierarchy." FINRA appreciates these recommendations and is exploring ways for firms to provide this information to FINRA and other state regulators in a more efficient manner.

Risk Assessment (Proposed Rule 3110.19(e))

As referenced above, FINRA is proposing to add a requirement for a member firm to conduct and document a risk assessment prior to designating an office or location as an RSL in accordance with the requirements of proposed Rule 3110.19. The proposed risk assessment would set forth a non-exhaustive list of factors a firm must consider and document before RSL designation, including customer complaints and heightened supervision.

Under proposed new Rule 3110.19(e), prior to designating an office or location as an RSL, a member must develop a reasonable risk-based approach to designating an office or location as an RSL and conduct and document a risk assessment for the associated person assigned to that office or location. In addition, the assessment must document the factors considered, including among others, whether the associated person at such office or location is now subject to: (1) customer complaints, taking into account the volume and nature of the complaints; (2) heightened supervision other than where such office or

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[25] See note 22, supra.

location is ineligible for RSL designation under proposed Rule 3110.19(c)(3); (3) any failure to comply with the member's written supervisory procedures; (4) any recordkeeping violation; and (5) any regulatory communications from a Regulator, including but not limited to, subpoenas, preliminary or routine regulatory inquiries or requests for information, deficiency letters, "blue sheet" requests or other trading questionnaires, or examinations indicating that the associated person at such office or location failed reasonably to supervise another person subject to their supervision. Proposed Rule 3110.19(e) would require a member to take into account any higher risk activities that take place or a higher risk associated person that is assigned to that office or location. Further, consistent with its obligation under Rule 3110(a) (Supervisory System), the member's supervisory system must take into consideration any indicators of irregularities or misconduct (i.e., "red flags") when designating an office or location as an RSL. In addition, proposed Rule 3110.19(e) would provide that red flags should also be reviewed in determining whether it is reasonable to maintain the RSL designation of such office or location in accordance with the requirements of proposed Rule 3110.19 and the member should consider evidencing steps taken to address those red flags where appropriate.

FINRA believes that the proposed risk assessment and accompanying documentation requirement would strengthen supervisory controls to further protect investors by requiring firms to consider higher risk criteria in determining whether to designate an office or location as an RSL.

Other Comments

- *RSL Inspection Schedule*

As explained in the 2022 RSL Rule Filing and in the Initial Proposal, an RSL would be categorized as a non-branch location, and as such, would become subject to an inspection on a regular periodic schedule.[26] NASAA and PIABA express concern over this inspection schedule, stating that RSLs should be subject to an annual inspection cycle. Their stance is derived from their fundamental concerns about a firm's ability to effectively supervise associated persons who work from their private residences, which FINRA believes is not a new workplace model. FINRA notes that under the current branch office definition and its exclusions, firms are already permitted to allow associated persons to work from their primary residences and non-primary residences (i.e., vacation or second

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[26] See Rule 3110.13 (General Presumption of Three-Year Limit for Periodic Inspections Schedules) (providing, in part, that "there is a general presumption that a non-branch location will be inspected at least every three years, even in the absence of any indicators of irregularities or misconduct (i.e., 'red flags'). If a member establishes a longer periodic inspection schedule, the member must document in its written supervisory and inspection procedures the factors used in determining that a longer periodic inspection cycle is appropriate.").

homes), subject to many of the same conditions proposed for an RSL.[27] Moreover, the proposed rule change would enhance these controls by adding further conditions to proposed Rule 3110.19. While NASAA acknowledges that supervisory functions do not present the same risks as sales activities,[28] it nevertheless believes that proposed Rule 3110.19 would not adequately ensure effective supervision and may put investors at risk. NASAA states that supervisory functions merit "regular scrutiny" and that "less frequent inspections could result in failures to promptly identify supervisory lapses and tangible investor harms." NASAA further states that the Initial Proposal "does not propose to require firms to enhance other supervisory components to address the likely shortfall that would come with less frequent onsite inspections." PIABA believes that it would be a mistake for an RSL to be subject to the regular periodic inspection schedule of a non-branch location because "[t]here are some things that technology cannot [detect]" (e.g., an advisor's home, car, and other assets; files or other documents related to "selling away"). For this reason, PIABA states that an RSL should "at minimum be subject to annual in person audits, if not more frequent unannounced visits, rather than periodic inspections every three years."

FINRA believes that the comments recommending that RSLs undergo an annual inspection schedule like OSJs and supervisory branch offices, but unlike all the other existing non-branch locations, which include residential locations, would impede the modernizing effort to "[strike] the right balance between providing flexibility to broker-dealer firms to accommodate the needs of their associated persons, while at the same time setting forth parameters that should ensure that all locations, including home offices, are appropriately supervised."[29] To be clear, proposed Rule 3110.19 is intended to shift some offices or locations to a regular periodic inspection schedule from an annual inspection schedule. Notably, the ability to make this shift, however, would be subject to a rigorous set of safeguards and conditions that FINRA believes align with the regulatory purposes of Rule 3110.

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27 See Rule 3110(f)(2)(A)(ii) and (iii).

28 FINRA notes that an associated person's location, other than a primary residence (e.g., vacation or second home) may be a non-branch location that is excluded from branch office registration only if such residence is used for securities business for less than 30 business days in any calendar year, provided that the firm complies with the provisions of Rule 3110(f)(2)(A)(ii)a. through h. See Rule 3110(f)(2)(A)(iii).

29 See Securities Exchange Act Release No. 52403 (September 9, 2005), 70 FR 54782 (September 16, 2005) (Order Approving File No. SR-NASD-2003-104), 70 FR 54782, 54787. See also Initial Proposal, supra note 1, 88 FR 20568, 20575.

FINRA emphasizes that the inspection requirement is only one part of a firm's supervisory system, and a firm's inspection of an office or location is not the only occasion during which a firm supervises its associated persons. Rule 3110(c)(1) sets forth the mandatory inspection cycles for all offices and locations and does not preclude a firm from conducting inspections of its offices or locations more frequently or conducting unannounced visits. Moreover, Rule 3110 requires a firm to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules – significantly, this is an ongoing obligation. As such, FINRA believes that the regular periodic inspection schedule for an RSL remains appropriate in light of the general requirements under Rule 3110 and the substantial safeguards and limitations set forth under proposed Rule 3110.19, and to impose an annual inspection cycle on an RSL would adversely impact the utility of the proposed new residential non-branch location. If RSLs and OSJs (and supervising branch offices) are both subject to an annual inspection requirement, a member firm may well elect to register a private residence as an OSJ and conduct annual inspections rather than comply with the proposed conditions, criteria and other requirements set forth in the Initial Proposal and Partial Amendment. If firms make that choice, FINRA believes that the potential benefits to firms and investors of firms' ability to recruit and retain diverse talent and better allocate compliance resources will be diminished or lost. Fidelity notes, for example, that annual inspections of private residences with employees conducting limited supervisory functions "result in expenses and productivity losses that are disproportionate relative to the supervisory benefits realized." With respect to talent retention and recruitment, Davenport believes, for example, that the proposed rule change aligns with its efforts to enhance workforce diversity. In addition, MMLIS states that "flexibility in alternative work arrangements has been crucial to the recruitment and retention of qualified individuals within our industry[,]" and believes that the proposed rule change "will enable firms to recruit underrepresented talent more effectively, particularly where firms may be in locations that do not have a local source of diversity."

FINRA emphasizes that the RSL designation is achieved only after a firm satisfies a rigorous set of criteria and conditions, including conducting and documenting a risk assessment, and the firm's willingness to provide a list of RSLs to FINRA on a quarterly basis. Overall, proposed Rule 3110.19 would confine RSL eligibility to locations that conduct a limited range of supervisory functions, and FINRA believes such activities could be appropriately inspected on a regular periodic schedule, subject to many of the same safeguards and conditions applied today to the residential non-branch locations under Rule 3110(f)(2)(A). In contrast, for example, an OSJ designation is driven solely by function. FINRA believes that NASAA's concern of any "shortfall" that may result due to a regular periodic inspection schedule rather than an annual one would be mitigated by the proposed additional enhancements to proposed Rule 3110.19.

- *Reconsider the Inspection Requirement for Limited Purpose Broker-Dealers*

Nationwide recommends that FINRA reexamine the frequency and the manner in which inspections are conducted, suggesting that inspections for limited purpose broker-dealers in particular should be conducted remotely and subject to a longer cycle (e.g., five years). FINRA considers this recommendation beyond the scope of the proposed rule change. However, FINRA will consider comments to revise the inspection requirements more generally as part of any future initiatives to consider the OSJ and branch office definitions more broadly.

SEC Action

Several commenters[30] urge the SEC to consider the proposed rule change with FINRA's separate proposal to establish a remote inspection pilot program.[31] Fidelity requests an extension of Rule 3110.17 (Temporary Relief to Allow Remote Inspections for Calendar Years 2020, 2021, 2022, and 2023) should the SEC need additional time to consider the proposed rule change.[32]

While FINRA understands the parallel timing of the two proposals, FINRA emphasizes that the two proposals are distinct and that member firms should engage in a discrete analysis under the respective terms of the proposals, as some member firms may elect to designate eligible private residences as RSLs but not elect to participate in the proposed remote inspection pilot program, if both are approved. Alternatively, a firm may opt not to designate RSLs pursuant to proposed Rule 3110.19, but choose to participate in the proposed pilot program.

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30 See ASA, Citigroup and Fidelity.

31 See Securities Exchange Act Release No. 97398 (April 28, 2023), 88 FR 28620 (May 4, 2023) (Notice of Filing of File No. SR-FINRA-2023-007).

32 FINRA notes that the regulatory relief provided under MSRB Rule G-27 (Supervision), allowing dealers to conduct their inspections remotely, has been extended to June 30, 2024. See Securities Exchange Act Release No. 97423 (May 2, 2023), 88 FR 29774 (May 8, 2023) (Notice of Filing and Immediate Effectiveness of File No. SR-MSRB-2023-04).

FINRA believes that the foregoing responds to the material issues raised by the commenters to the rule filing and has determined not to amend the Proposal in response to comments. If you have any questions, please contact me at (202) 728-8471, email: Sarah.Kwak@finra.org.

Best regards,

/s/ Sarah Kwak

Sarah Kwak
Associate General Counsel
Office of General Counsel

Attachment A: Alphabetical List of Commenters to File No. SR-FINRA-2023-006

1. David T. Bellaire, Financial Services Institute ("FSI"), (April 27, 2023)

2. Hugh Berkson, Public Investors Advocate Bar Association ("PIABA") (April 26, 2023)

3. Bernard V. Canepa, Securities Industry and Financial Markets Association ("SIFMA") (April 27, 2023)

4. Andrew Hartnett, North American Securities Administrators Association, Inc. ("NASAA") (April 27, 2023)

5. Christopher A. Iacovella, American Securities Association ("ASA") (May 25, 2023)

6. Clifford Kirsch & Eric Arnold, Eversheds Sutherland (US) LLP on behalf of the Committee of Annuity Insurers (the "CAI") (April 27, 2023)

7. Scott C. Kursman, Citigroup Global Markets, Inc. ("Citigroup"), (April 28, 2023)

8. Theresa J. Manderski, Davenport & Company LLC ("Davenport") (April 27, 2023)

9. Gail Merken, Janet Dyer & John McGinty, Fidelity Investments ("Fidelity") (April 27, 2023)

10. Mark Quinn, Cetera Financial Group ("Cetera") (April 27, 2023)

11. James Rabenstine & Holly Butson, Nationwide Financial Services, Inc. ("Nationwide") (April 24, 2023)

12. Mark Segginger, LPL Financial ("LPL") (May 25, 2023)

13. Karol Sierra-Yanez, MML Investors Services, LLC ("MMLIS"), (April 25, 2023)