

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-97839; File No. SR-FINRA-2023-006)

July 5, 2023

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change, as modified by Amendment No. 1, to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision)

I. Introduction

On March 29, 2023, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission” or “SEC”) proposed rule change SR-FINRA-2023-006 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder to adopt new Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision), which would treat a private residence at which an associated person engages in specified supervisory activities as a non-branch location, subject to safeguards and limitations.<sup>3</sup> The proposed rule change was published for public comment in the Federal Register on April 6, 2023.<sup>4</sup> The Commission received thirteen comment letters related to this filing.<sup>5</sup> On May 16, 2023, FINRA consented to an extension of the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Exchange Act Release No. 97237 (Mar. 31, 2023), 88 FR 20568 (Apr. 6, 2023) (File No. SR-FINRA-2023-006) (hereinafter, the “Notice”).

<sup>4</sup> See id.

<sup>5</sup> The comment letters are available at <https://www.sec.gov/comments/sr-finra-2023-006/srfinra2023006.htm>.

approve or disapprove the proposed rule change to July 5, 2023.<sup>6</sup> On July 3, 2023, FINRA filed an amendment to modify the proposed rule change (“Amendment No. 1”).<sup>7</sup>

The Commission is publishing this order pursuant to Section 19(b)(2)(B) of the Exchange Act<sup>8</sup> to solicit comments on the proposed rule change, as modified by Amendment No. 1, and to institute proceedings to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1 (hereinafter referred to as the “proposed rule change” unless otherwise specified).

## II. Description of the Proposed Rule Change, as Modified by Amendment No. 1

### A. Background

Currently under FINRA rules, a private residence at which certain supervisory functions occur would need to be registered and designated as a branch office or office of supervisory jurisdiction (“OSJ”) under Rule 3110(a)(3) and inspected at least annually under Rule 3110(c)(1)(A). However, as part of its response to the COVID-19 pandemic, FINRA temporarily suspended the requirement for member firms to submit branch office registration applications on Form BR (Uniform Branch Office Registration Form) for any newly opened temporary office locations or space-sharing arrangements established as a result of the pandemic (the “Form BR Temporary Suspension”).<sup>9</sup>

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<sup>6</sup> See letter from Sarah Kwak, Associate General Counsel, Office of General Counsel, FINRA, to Daniel Fisher, Branch Chief, Division of Trading and Markets, U.S. Securities and Exchange Commission (May 16, 2023), available at <https://www.finra.org/sites/default/files/2023-05/sr-finra-2023-006-extension-no-1.pdf>.

<sup>7</sup> See Amendment No. 1, available at <https://www.finra.org/rules-guidance/rule-filings/sr-finra-2023-006>.

<sup>8</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>9</sup> See FINRA Regulatory Notice 20-08 (Mar. 9, 2020) (“Regulatory Notice 20-08”), available at <https://www.finra.org/rules-guidance/notices/20-08>; see also Notice at 20569 n.7.

FINRA stated that absent further regulatory action, once the Form BR Temporary Suspension is lifted, FINRA rules would require member firms to “either curtail activities at residential locations or register large numbers of residential locations as OSJs or supervisory branch offices.”<sup>10</sup> Registering a private residence as an OSJ or supervisory branch office would impose a corresponding annual inspection requirement.<sup>11</sup> Under the proposed rule change, a new location designation, Residential Supervisory Location (“RSL”), would be treated as a non-branch location, subject to inspections on a regular periodic schedule under Rule 3110(c)(1)(C), presumed to be every three years.<sup>12</sup>

**B. Proposed Rule Change, as Modified by Amendment No. 1**

FINRA is proposing to adopt new Supplementary Material .19 under Rule 3110 to establish an RSL designation that would treat an eligible location as a non-branch location (i.e., exclude it from branch office registration and the corresponding annual inspection requirement), subject to specified limitations and conditions, as described below.

**1. Conditions for Designation as a Residential Supervisory Location**

Under proposed Rule 3110.19(a), an associated person’s private residence where supervisory activities are conducted (i.e., an RSL) shall be considered for those activities a non-branch location (and thus excluded from branch-office registration and the corresponding annual inspection requirement), provided that: (1) only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct

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<sup>10</sup> Notice at 20579.

<sup>11</sup> FINRA Rule 3110(c)(1)(A).

<sup>12</sup> See FINRA Rules 3110(c)(1)(C), 3110.13; Proposed Rule 3110.19(a).

business at the location;<sup>13</sup> (2) the location is not held out to the public as an office;<sup>14</sup> (3) the associated person does not meet with customers or prospective customers at the location;<sup>15</sup> (4) any sales activity that takes place at the location complies with the conditions set forth under Rule 3110(f)(2)(A)(ii) or (iii);<sup>16</sup> (5) neither customer funds nor securities are handled at that location;<sup>17</sup> (6) the associated person is assigned to a designated branch office, and such designated branch office is reflected on all business cards, stationery, retail communications, and other communications to the public by such associated person;<sup>18</sup> (7) the associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with Rule 3110;<sup>19</sup> (8) the associated person's electronic communications (e.g., email) are made through the member's electronic system;<sup>20</sup> (9)(A) the member has a recordkeeping system to make and keep current, and preserved records required to be made and kept current, and preserved under applicable securities laws and regulations, FINRA rules, and the member's own written supervisory procedures under Rule 3110; (9)(B) such records are not physically or electronically maintained and preserved at the office or location; and (9)(C) the member has prompt access to such records;<sup>21</sup> and (10) the member has determined that its surveillance and technology tools are appropriate to supervise the types of risks presented by each RSL; these

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<sup>13</sup> See proposed Rule 3110.19(a)(1).

<sup>14</sup> See proposed Rule 3110.19(a)(2).

<sup>15</sup> See proposed Rule 3110.19(a)(3).

<sup>16</sup> See proposed Rule 3110.19(a)(4).

<sup>17</sup> See proposed Rule 3110.19(a)(5).

<sup>18</sup> See proposed Rule 3110.19(a)(6).

<sup>19</sup> See proposed Rule 3110.19(a)(7).

<sup>20</sup> See proposed Rule 3110.19(a)(8).

<sup>21</sup> See proposed Rule 3110.19(a)(9).

tools may include but are not limited to: (A) firm-wide tools such as, an electronic recordkeeping system; electronic surveillance of email and correspondence; electronic trade blotters; regular activity-based sampling reviews; and tools for visual inspections; (B) tools specific to the RSL based on the activities of the associated person assigned to the location, products offered, and restrictions on the activity of the RSL; and (C) system tools, such as secure network connections and effective cybersecurity protocols.<sup>22</sup>

## 2. Member Firm Ineligibility Criteria

Under proposed Rule 3110.19(b), a member firm would be ineligible to designate any of its offices or locations as an RSL if the member: (1) is currently designated as a Restricted Firm under Rule 4111 (Restricted Firm Obligations);<sup>23</sup> (2) is currently designated as a Taping Firm under Rule 3170 (Tape Recording of Registered Persons by Certain Firms);<sup>24</sup> (3) 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;<sup>25</sup> (4) receives a notice from FINRA pursuant to Rule 9557 (Procedures for Regulating Activities under Rule 4110 (Capital Compliance), Rule 4120 (Regulatory Notification and Business Curtailment) or Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties)), unless FINRA has otherwise permitted activities in writing pursuant to such rule;<sup>26</sup> (5) is or becomes suspended by FINRA;<sup>27</sup> (6) based on the date in the Central Registration Depository, had its FINRA

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<sup>22</sup> See proposed Rule 3110.19(a)(10).

<sup>23</sup> See proposed Rule 3110.19(b)(1).

<sup>24</sup> See proposed Rule 3110.19(b)(2).

<sup>25</sup> See proposed Rule 3110.19(b)(3).

<sup>26</sup> See proposed Rule 3110.19(b)(4).

<sup>27</sup> See proposed Rule 3110.19(b)(5).

membership become effective within the prior twelve months;<sup>28</sup> or (7) is or has been found within the past three years by the SEC or FINRA to have violated Rule 3110(c).<sup>29</sup>

### 3. Location Ineligibility Criteria

As originally proposed, under proposed Rule 3110.19(c), a specific location of an otherwise eligible member would be ineligible for designation as an RSL if one or more associated persons at the location: (1) is a designated supervisor who has less than one year of direct supervisory experience with the member;<sup>30</sup> (2) is functioning as a principal for a limited period in accordance with Rule 1210.04 (Registration Requirements);<sup>31</sup> (3) is subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA, or a state regulatory agency;<sup>32</sup> (4) 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 proposed Rule 3110.19(c)(3) or otherwise as a condition to approval or permission for such association;<sup>33</sup> (5) 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 (Uniform Application for Securities Industry Registration or Transfer Registration);<sup>34</sup> or (6) is currently subject to, or has been notified in writing that it will be subject to, any investigation, proceeding, complaint or

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<sup>28</sup> See proposed Rule 3110.19(b)(6).

<sup>29</sup> See proposed Rule 3110.19(b)(7).

<sup>30</sup> See proposed Rule 3110.19(c)(1).

<sup>31</sup> See proposed Rule 3110.19(c)(2).

<sup>32</sup> See proposed Rule 3110.19(c)(3).

<sup>33</sup> See proposed Rule 3110.19(c)(4).

<sup>34</sup> See proposed Rule 3110.19(c)(5). Form U4’s Questions 14A(1)(a) and 2(a), 14B(1)(a) and 2(a) elicit reporting of criminal convictions, and Questions 14C, 14D, and 14E pertain to regulatory action disclosures. See Notice 20577 n.97.

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, any state law pertaining to the regulation of securities or any rule or regulation under any of such Acts or laws, or any of the rules of the Municipal Securities Rulemaking Board (“MSRB”) or FINRA.<sup>35</sup>

Amendment No. 1 would modify two of these six originally proposed criteria. Specifically, Amendment No. 1 would modify proposed Rule 3110.19(c)(1) to provide that an office or location would be ineligible for RSL designation if one or more associated persons at such office or location is a designated supervisor who has less than one year of direct supervisory experience with the member, or an affiliate or subsidiary of the member that is registered as a broker-dealer or investment adviser.<sup>36</sup>

Amendment No. 1 also would modify proposed Rule 3110.19(c)(6). As 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 associated person is now subject to any Investigation or Proceeding, as such terms are defined in the Explanation of Terms for the Form U4, 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 they have failed reasonably to supervise another person subject to their supervision, with a view to preventing the violation of any

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<sup>35</sup> See proposed Rule 3110.19(c)(6).

<sup>36</sup> See proposed Rule 3110.19(c)(1); Amendment No. 1.

provision of the Securities Act of 1933, the Exchange Act, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, any state law pertaining to the regulation of securities or any rule or regulation under any of such acts or laws, or any of the rules of the MSRB or other self-regulatory organization, including FINRA.<sup>37</sup> Further, Amendment No. 1 would permit such office or location to 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.<sup>38</sup>

#### 4. Obligation to Provide List of RSLs to FINRA

Under proposed Rule 3110.19(d), any member that elects to designate any office or location of the member as an RSL pursuant to proposed Rule 3110.19 shall 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.

#### 5. Risk Assessment

Amendment No. 1 would further modify the proposed rule change by adding proposed Rule 3110.19(e).<sup>39</sup> This proposed rule change would require a member – prior to designating an office or location as an RSL – to develop a reasonable risk-based approach to designating the office or location as an RSL, and conduct and document a risk assessment for the associated

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<sup>37</sup> See proposed Rule 3110.19(c)(6); Amendment No. 1.

<sup>38</sup> See *id.*

<sup>39</sup> Proposed Rule 3110.19(e); Amendment No. 1.

person assigned to that office or location.<sup>40</sup> This proposed rule change would require documentation of 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 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.<sup>41</sup> Furthermore, this proposed rule change would require the member to account for any higher risk activities that take place or a higher risk associated person that is assigned to that office or location.<sup>42</sup>

Amendment No. 1 also would provide – as part of proposed Rule 3110.19(e) – that (consistent with its obligation under Rule 3110(a)) 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.<sup>43</sup> Further, this proposed rule change would provide that red flags should be reviewed in determining whether it is reasonable to maintain the RSL designation of an office or location in accordance with the requirements of proposed Rule

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<sup>40</sup> Proposed Rule 3110.19(e).

<sup>41</sup> Id.

<sup>42</sup> Id.

<sup>43</sup> Id.

3110.19, and that the member should consider evidencing steps taken to address those red flags where appropriate.<sup>44</sup>

III. Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2023-006 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act to determine whether the proposed rule change, as modified by Amendment No. 1, should be approved or disapproved.<sup>45</sup> Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change, as modified by Amendment No. 1. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to the proposed rule change, as modified by Amendment No. 1.

Pursuant to Section 19(b)(2)(B) of the Exchange Act, the Commission is providing notice of the grounds for disapproval under consideration.<sup>46</sup> The Commission is instituting proceedings to allow for additional analysis and input concerning whether the proposed rule change, as modified by Amendment No. 1, is consistent with the Exchange Act and the rules thereunder.

IV. Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposed rule change, as modified by Amendment No. 1. In particular, the Commission invites the written views of interested persons concerning whether

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<sup>44</sup> Id.

<sup>45</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>46</sup> Id.

the proposed rule change, as modified by Amendment No. 1, is consistent with the Exchange Act and the rules thereunder.

Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>47</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change, as modified by Amendment No. 1, should be approved or disapproved by [insert date 21 days after the date of publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days after the date of publication in the Federal Register].

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's internet comment form (<https://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include file number SR-FINRA-2023-006 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to file number SR-FINRA-2023-006. This file number should be included on the subject line if email is used. To help the Commission process and review your

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<sup>47</sup> Section 19(b)(2) of the Exchange Act, as amended by the Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<https://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change, as modified by Amendment No. 1, that are filed with the Commission, and all written communications relating to the proposed rule change, as modified by Amendment No. 1, between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to file number SR-FINRA-2023-006 and should be submitted on or before [insert date 21 days after the date of publication in the Federal Register]. If comments are received, any rebuttal comments should be submitted on or before [insert date 35 days after the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>48</sup>

**Sherry R. Haywood,**

*Assistant Secretary.*

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<sup>48</sup> 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(57).