



July 26, 2023

Submitted by SEC Webform (<http://www.sec.gov/rules/sro.shtml>)

Sherry R. Haywood
Assistant Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: File No. SR-FINRA-2023-006: 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)

Dear Ms. Haywood:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),¹ I am writing in response to U.S. Securities and Exchange Commission (“SEC” or the “Commission”) Release No. 34-97839, *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)*.²

The proposed Amendment No. 1 addresses various comments submitted regarding the March 2023 proposal³ (collectively, the “RSL Proposal”), including some of NASAA’s comments.⁴ Overall, the proposed amendments to the RSL Proposal strike a more appropriate

¹ Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, the U.S. Virgin Islands, and Guam. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

² SEC Release No. 34-97839 is available at <https://www.sec.gov/rules/sro/finra/2023/34-97839.pdf>. Amendment No. 1, as filed with the SEC on Form 19b-4, is available at <https://www.finra.org/sites/default/files/2023-07/sr-2023-006-amendment-No1.pdf>.

³ See *Notice of Filing of a Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision)*, SEC Release No. 34-97237 at 2 n.5 (Mar. 31, 2023), <https://www.sec.gov/rules/sro/finra/2023/34-97237.pdf>.

⁴ See Letter from Andrew Hartnett, NASAA President and Deputy Commissioner, Iowa Insurance Division, to Sherry R. Haywood, Assistant Secretary, *Re: File No. SR-FINRA-2023-006* (Apr. 27, 2023),

regulatory balance on the specific issues addressed. The RSL Proposal could be improved, however, as described below, and by establishing an annual inspection schedule for each residential supervisory location (each an “RSL”). Although we continue to have reservations about loosening supervisory scrutiny of remote offices,⁵ the changes described herein will further strengthen the RSL Proposal and are necessary for the proposal to be considered acceptable for approval.

I. Regulatory Actions and Investigations

As amended, the RSL Proposal would provide that a location is ineligible for RSL status if one or more associated persons at that location has been notified in writing that they are subject to any investigation or proceeding (defined by reference to the Explanation of Terms for the Form U4) by regulators “expressly alleging” a supervisory violation under the relevant securities laws or rules. The amended RSL Proposal would further provide that a firm can designate or redesignate a location that may previously have been ineligible on this basis when the firm either receives written notification from the regulator that the investigation has concluded without further action, or one year from the last communication from that regulator relating to the investigation. Finally, Amendment No. 1 would require a firm to conduct and document a risk assessment prior to designating a location as an RSL, which must include, among other things, any failure by an associated person at a prospective location to comply with the firm’s written supervisory procedures and any regulatory communications relating to investigations that do not meet the thresholds for *per se* ineligibility.

NASAA generally supports the proposed approach, and we believe that it appropriately balances regulators’ interest in maintaining high industry standards with the concerns raised by the securities industry as a basis to exclude state securities laws from the RSL designation process.⁶

<https://www.nasaa.org/wp-content/uploads/2023/04/NASAA-Comment-Letter-re-SR-FINRA-2023-006-4-27-23.pdf>.

⁵ See NASAA Letter (April 2023); Letter from Andrew Hartnett, NASAA President and Deputy Commissioner, Iowa Insurance Division, to J. Lynn Taylor, Assistant Secretary, *Re: File No. SR-FINRA-2022-019* (Nov. 25, 2022), <https://www.nasaa.org/wp-content/uploads/2022/11/NASAA-Comment-Letter-re-SR-FINRA-2022-019-11-25-2022.pdf>; Letter from Melanie Senter Lubin, NASAA President and Maryland Securities Commissioner, to J. Matthew DeLesDernier, Assistant Secretary, *Re: File Nos. SR-FINRA-2022-021 and SR-FINRA-2022-019* (Aug. 23, 2022), <https://www.nasaa.org/wp-content/uploads/2022/08/2022-08-23-NASAA-Comment-Letter-on-SR-FINRA-2022-019-and-021-redacted.pdf>.

⁶ See Amendment No. 1, at 6. The industry’s arguments about purported practical challenges in tracking and applying this criterion generally lack merit and FINRA was right to reject the suggestion to exclude state securities laws from the RSL Proposal. See *id.* The notion that Form U4 does not require disclosure of state regulatory actions and investigations is incorrect. Item 14G requires disclosure where the filer has been notified in writing that it is the subject of a proceeding or investigation that could result in a “yes” answer to, *inter alia*, Item 14C, D, or E. A filer must answer “yes” to Item 14D if any state regulatory agency has “found [them] to have been involved in a violation of investment-related regulation(s) or statute(s),” “found [them] to have been a cause of an investment-related business having its authorization to do business denied, suspended, revoked or restricted,” “entered an order against [them] in connection with an investment-related activity,” or “denied, suspended, or revoked [their] registration or license or otherwise, by order, prevented [them] from associating with an investment-related business or restricted [their] activities” – any or all of which could reasonably apply to supervisory violations. See [Uniform](#)

As amended, the RSL Proposal gives appropriate weight to federal, SRO, and state regulatory actions related to supervision, while recognizing that not all complaints or investigations *necessarily* result in an alleged supervisory violation. It also reduces the likelihood that a location remains ineligible for longer than reasonably necessary for a regulator to investigate potential misconduct, while allowing regulators sufficient flexibility to conduct a thorough investigation. Any comments suggesting that the one-year re-eligibility threshold be shortened should be rejected outright. Investigations take time and the amended RSL Proposal strikes an acceptable balance between the need for flexibility in time and resource allocation, and the desire for a definable off-ramp from ineligibility when an investigation has been pending for a period of time without movement.

Though we generally agree with the amended RSL Proposal in this regard, it should be further clarified as follows to ensure that it is construed and applied broadly, consistent with a fair reading of its operative provisions. First, FINRA notes in Amendment No. 1 that the “expressly alleging” threshold in proposed Rule 3110.19(c)(6) “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.” This is an appropriate standard, and it should be incorporated into the text of proposed Rule 3110.19. Incorporating this standard into the rule text would ensure that all firms are fully aware of their responsibilities and reduce the chance of noncompliance based on misinterpretation of the proposed rule.

Second, FINRA should clarify that a “Wells” notice or equivalent procedure is not a prerequisite for ineligibility under this criterion. Although the Explanation of Terms defines “Investigation” by reference to the “Wells” notice for investigations by the SEC, FINRA, and NYSE, it includes no such limitation with respect to “formal investigations by other SROs” and “actions or procedures designated as investigations by jurisdictions [*e.g.*, state securities regulators].”⁷ Further, as SEC staff is aware, a Wells notice usually signals the end of an investigation because it serves as the point at which the staff is prepared to recommend charges to the Commission. If one of the purposes of this provision is to prevent a firm from granting RSL status to an associated person under investigation for potential supervisory failures, that disqualification must happen earlier in the investigative process. Third, and finally, FINRA should clarify that, while subpoenas and certain other regulatory communications are not distinct “investigations” in and of themselves, such communications can nonetheless provide notice of an

[Securities Act \(1956\) \(as amended from time to time by NASAA\)](#), § 204; [Uniform Securities Act \(2002\)](#), § 412.

The fact that Item 14D does not explicitly reference state-law supervisory violations is of no significance. A firm that is capable of determining whether an action or investigation by the SEC or FINRA “could result in a ‘yes’ answer to” Items 14C(8) (failure-to-supervise actions by the SEC and CFTC) or 14E(7) (failure-to-supervise actions by FINRA), *see* Item 14G, is also capable of determining whether a state regulatory investigation or action could result in alleged supervisory violations for purposes of determining RSL eligibility, and it would be equally inappropriate to designate an RSL in the face of a state regulatory action or investigation.

⁷ Form U4 Explanation of Terms, “Investigation” at (e), (f), <https://www.finra.org/sites/default/files/AppSupportDoc/p468051.pdf>.

“investigation” and can satisfy the “expressly alleging” threshold depending on the information contained therein.⁸

II. Heightened Supervision

The RSL Proposal would provide that a location is ineligible for RSL status if one or more associated persons at that location is subject to a mandatory heightened supervisory plan under the rules of the SEC, FINRA, or a state regulatory agency. NASAA previously urged FINRA to include heightened supervisory plans imposed by the firm itself because this criterion could otherwise be underinclusive of circumstances that warrant heightened scrutiny.⁹ FINRA declined to expand this criterion to include heightened supervisory plans imposed by the firm, and instead the amended RSL Proposal would require a firm to consider such voluntary plans as part of its pre-designation risk assessment. This approach strikes an acceptable balance between NASAA’s concerns and FINRA’s desire not to disincentivize firms from taking such steps to proactively improve their supervisory systems.

III. Supervisory Experience with the Member Firm

As amended, the RSL Proposal would provide that a location is ineligible for RSL status if one or more associated persons at the location has less than one year of direct supervisory experience with the firm, or with an affiliate or subsidiary that is a registered broker-dealer or investment adviser. We agree with FINRA that this ineligibility criterion is necessary to ensure that supervisors in dispersed locations have the appropriate level of experience with the firm’s systems, personnel, operations, and culture to supervise effectively.¹⁰ The amended RSL Proposal would allow supervisors to aggregate their experience among the firm and its affiliates and subsidiaries to meet the one-year requirement. We agree that this amendment strikes an appropriate balance between regulators’ interest in high supervisory standards and industry concerns about the impact on hiring efforts.

IV. Frequency of Inspection of RSLs

Finally, proposed Rule 3110.19 should be revised to provide, consistent with Rule 3110(c)(1)(A), that each firm must inspect each RSL “at least annually (on a calendar-year basis).” One of the principal effects of the RSL Proposal would be to reduce the frequency of firms’ supervisory inspections of these locations from annually to “presum[ably] . . . at least every three years.”¹¹ NASAA understands, and we do not categorically oppose, FINRA’s initiatives to adjust certain regulatory requirements to accommodate hybrid work arrangements, where appropriate.

⁸ For example, subpoenas and request or demand letters often include a matter number and other information signifying a regulatory investigation.

⁹ See, e.g., NASAA Letter (April 2023) at 4-5; NASAA Letter (November 2022) at 5.

¹⁰ See Amendment No. 1 at 4.

¹¹ See Rule 3110.13.

However, the purported benefits of hybrid working arrangements must not come at the expense of investor protection, high standards of conduct in the securities industry, or close scrutiny of firms' activities.

As explained in our earlier comment letters,¹² FINRA has not shown that supervisory functions present sufficiently “lower risk” to warrant loosening oversight of the individuals performing those functions. Although supervisory functions do not present the same kinds of risk as do sales activities, for example, the former are not “low risk” and are in fact an integral component of overall risk mitigation. Effective firm supervision of associated persons is a critical component of the broader investor protection framework under state and federal securities laws. Associated persons who perform supervisory functions are intended to be a first line of defense, compliance, and risk mitigation within their firms. Lax or otherwise ineffective supervision can result in the failure to stop preventable harms before they occur, or even exacerbate harms that have already begun. Thus, it is exceptionally important that supervisory functions be subject to regular scrutiny by firms to ensure that they are operating effectively. Indeed, Rule 3110 expressly requires that supervisory locations be inspected more frequently than non-supervisory locations.¹³ Additionally, both FINRA and the SEC have long recognized that regular inspection is especially important for small, remote offices.¹⁴

Accordingly, the RSL Proposal should be revised to establish an annual inspection schedule for RSLs. FINRA's continued reluctance to make this sensible revision is concerning, given the important role of inspections in the supervisory structure. If FINRA is confident that reducing the frequency of inspections is acceptable, it should include its reasoning for reaching that conclusion in its filing with the Commission.

V. Conclusion

In general, NASAA believes that Amendment No. 1 to the RSL Proposal reflects an appropriate regulatory balance of the concerns expressed by various commenters on the issues addressed. However, the RSL Proposal can be further improved as described above and, in particular, should be modified to establish an annual inspection schedule for RSLs. Although we continue to have reservations about loosening supervisory scrutiny of remote offices, the changes described herein will further strengthen the proposal and are necessary for the RSL Proposal to be considered acceptable for approval.

¹² See NASAA Letter (April 2023); NASAA Letter (November 2022); NASAA Letter (August 2022).

¹³ Compare Rule 3110(c)(1)(A) (requiring firms to inspect OSJs and supervisory branches “at least annually”) with Rule 3110(c)(1)(B) (requiring firms to inspect non-supervisory branches “at least every three years”).

¹⁴ See, e.g., FINRA, Regulatory Notice 14-10: Consolidated Supervision Rules (Mar. 2014), <https://www.finra.org/sites/default/files/NoticeDocument/p465940.pdf> (reminding firms to “conduct *focused reviews* of one-person OSJ locations”) (emphasis added); SEC Division of Market Regulation, Staff Legal Bulletin No. 17: Remote Office Supervision (Mar. 19, 2004), <https://www.sec.gov/tm/staff-legal-bulletin-17-remote-office-supervision> (“reminding broker-dealers that small, remote offices require *vigilant* supervision”) (emphasis added).

Sherry R. Haywood

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Thank you for considering these views. NASAA looks forward to continuing to work with the Commission and FINRA in the shared mission to protect investors. Should you have questions, please contact either the undersigned or NASAA's General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,

A handwritten signature in black ink that reads "Andrew Hartnett". The signature is written in a cursive, flowing style.

Andrew Hartnett
NASAA President and
Deputy Commissioner,
Iowa Insurance Division