



## PUBLIC INVESTORS ADVOCATE BAR ASSOCIATION

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December 7, 2022

**Via Email Only @ rule-comments@sec.gov**

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

**Re: SR-FINRA-2022-021 – Proposed Rule Change to Determine Whether To Approve or Disapprove a Proposed Rule Change To Adopt Supplementary Material .18 (Remote Inspections Pilot Program) Under FINRA Rule 3110**

Dear Ms. Countryman:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, 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, PIABA submits this comment to the SEC concerning FINRA's recent filing, with the Securities and Exchange Commission ("SEC" or "Commission"), of a proposed rule change to amend FINRA Rule 3110 (Supervision). Specifically, FINRA has filed with the Commission a proposed rule change to adopt supplementary material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision). The proposal would adopt a voluntary, three-year remote inspection pilot program to allow member firms to elect to fulfill their obligation under Rule 3110(c) (Internal Inspections) by conducting inspections of some or all branch offices and locations remotely without an on-site visit to such office or location, subject to specified terms.

The proposed rule was initially published for comment on August 15, 2022. PIABA submitted its comment on September 6, 2022, urging the Commission to reject the rule proposal.

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FINRA then consented to an extension of time through November 11, 2022, for the Commission to approve the rule, disapprove it, or institute proceedings to determine whether to approve or disapprove the proposal. As such, the rule was published again on November 16, 2022, and PIABA once again asks the SEC to reject the proposal.

## **Background**

FINRA's rule 3110(c)(1) was amended, effective in 2005, to codify the schedule by which member firms were to conduct on-site inspections of branch offices and unregistered offices (i.e., non-branch locations). *See* NTM 04-71. FINRA now states that widespread advancements in technology and communications in the financial industry have significantly changed the way in which members and their associated persons conduct their business and communicate, including the practices that formed the original bases for an on-site inspection requirement.

FINRA's present amendment filing contends that:  
the COVID-19 pandemic has accelerated the use of a wide variety of compliance and workplace technology as many government and private employers, including member firms, were driven to adopt a broad remote work environment by quickly moving their employees out of their usual office setting to an alternative worksite such as a private residence. Insights obtained from member firms and other industry representatives, through various pandemic-related initiatives and other industry outreach, have led FINRA to carefully consider whether some processes and rules, including the manner in which a firm may satisfy its Rule 3110(c) obligations, should be modernized . . . [and] technological improvements and developments in regulatory compliance have provided more tools than before to create more effective and efficient compliance programs. To that end, FINRA believes that regulatory models should evolve to benefit from the availability and use of effective technology tools.

Therefore, and ostensibly to address the operational challenges in conducting on-site inspections during the pandemic, FINRA adopted temporary Rule 3110.17, effective since November 2020, to provide member firms the option to conduct inspections of their branch offices and non-branch locations remotely, subject to specified terms therein. As such, FINRA believes now is the time to assess possible longer-term rule changes and is, therefore, proposing this voluntary, three-year remote inspections pilot program.

## **The Proposed Rule Would Almost Certainly Increase Investor Harm**

PIABA submits this comment because the bar association believes this amendment, much like the recently proposed amendment SR-FINRA-2022-019, to allow a home office to be considered residential supervisory location and impose rules and procedures for the supervision of same, 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 associated persons to skirt the rules.

There are some things that technology cannot detect, but would be found with little difficulty through an in-person audit. For example, when an auditor visits the advisor's office, the auditor can see their car and personal belongings, the signage on their building, the physical files in their office, whether they share office space with other professionals or businesses, etc. Many firms' compliance procedures ask supervisors to gauge whether the advisor is living within their means (or at least, their legitimate commissions or compensation), and this cannot be done effectively remotely or through in-person visits taking place every three years. Moreover, a remote inspection will not find evidence of files or other documents related to unapproved investments being recommended to customers (i.e., "selling away"). Our members have had cases where brokers sold unapproved investments with brochures and other offering documents left in plain sight of their office. Obviously, a remote inspection would not uncover such problems.

Enforcement actions by both FINRA and SEC call into question the propriety of the rule proposal. One such case is *In the Matter of Royal Alliance Associates, Inc.*, Release No. 38174, 63 S.E.C. 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.

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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). The SEC opined that firms using an independent broker model require greater supervision than that of a traditional wire house brokerage firm. The lack of unannounced audits of a far-away broker with no one looking over his shoulder was wholly deficient. The failure to adequately supervise the subject broker's conduct resulted in a nearly \$9 million Ponzi scheme.

Other regulatory actions involving brokers running "selling away" or Ponzi schemes from residential or remote (often one-broker) offices are too plentiful to count but include *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).

The proposal suggests that certain locations would be ineligible for the proposed pilot program, such as brokers with marks on Questions 14A, B, C, D, and E of their Form U4s. Given that the referenced sections of Question 14 all have to do with whether a court or regulatory issued a finding of a violation of law or regulation, associated persons who have simply been subject to customer complaints and settled them, were terminated for cause, have had judgments or liens issued against them, or are merely under a regulatory investigation would be eligible for the pilot program since none of that wrongdoing would be reportable under the referenced sections of Question 14. While one questions why problematic brokers should be subjected to substantially weakened supervision, one cannot question the likely outcome: meaningful investor harm.

The efficacy of remote electronic supervision is called into question given the existing scheme for surveillance of electronic communications. At present, firms commonly review a sampling of emails or electronic messages, leaving opportunities for bad actors to make improper sales presentations or commitments to clients via email or text so long as those messages do not trigger the key words used to flag potentially problematic communications. Our members have seen numerous cases where the broker engaged in selling away and openly discussed such through their firm-approved email address, but the firm did not detect it for years (or ever) because the firm simply did not see or review the emails.

Not surprisingly, most of the comments in support of this rule came from brokerage firms. However, FINRA and the SEC must look at how things have changed in the last year, or even within the last three months. More and more brokerage firms are asking their advisors and staff to return to the office. Numerous news articles have covered brokerage firms' return to work policies:

- a) <https://www.investmentnews.com/big-brokerages-gearing-up-for-return-to-the-office-208856> (July 2021) - discussing Morgan Stanley's and Raymond James' brokers' return to the office;
- b) [https://www.financialadvisoriq.com/c/3255614/411324/edward\\_jones\\_others\\_add\\_res\\_flexibility\\_needs\\_amid\\_return\\_offices](https://www.financialadvisoriq.com/c/3255614/411324/edward_jones_others_add_res_flexibility_needs_amid_return_offices) (July 2021) - discussing Edward Jones' expectation that most employees will return to the office, while LPL sought a hybrid approach;

- c) <https://www.advisorhub.com/exclusive-morgan-stanley-calls-brokers-back-to-offices-sets-90-day-cap-on-wfh/> (Mar 2022) – discussing Morgan Stanley’s policy that workers cannot work more than 90 days remotely per year, beginning July 1, 2022;
- d) <https://www.businessinsider.com/return-to-office-wall-street-covid19-goldman-jefferies-jpmorgan-2022-9> (Sep 2022) - discussing Jeffries’, Goldman Sachs’, Credit Suisse’s, and Morgan Stanley’s desire to have employees back in the office on a regular basis – “the underlying message is clear: Come back to your desks;”
- e) <https://www.reuters.com/business/finance/banks-ready-leave-pandemic-behind-staff-return-desks-2022-09-02/> (Sep 2022):
  - 1) discussing Goldman Sachs ending its Covid protocols on September 6, 2022;
  - 2) Morgan Stanley discontinuing Covid testing and monitoring effective September 5, 2022;
  - 3) Citigroup, Wells Fargo, and BlackRock all expected its employees to work at least three days per week in the office;
  - 4) Royal Bank of Canada was updating its policies and asking colleagues to come together more in-person.

In short, the argument that the Pandemic-related need to allow increased use of remote inspections, and the resulting need to use technological tools to remotely supervise those activities, is no longer compelling as the number of remote employees dwindles.

Certainly many industries have moved increasingly towards work from home or hybrid approaches. PIABA does not claim that such an arrangement would cause major problems for many brokers in the industry. However, FINRA’s purpose to “protect investors and ensure the market’s integrity”<sup>1</sup> cannot be brushed aside for the sake of convenience. FINRA’s rules exist to protect investors from bad actors. Even with the current rules, Ponzi schemes and similar scams are increasingly prevalent. In 2019 alone, “State and federal authorities uncovered 60 alleged Ponzi schemes last year with a total of \$3.25 billion in investor funds — the largest amount of money unearthed in these scams since 2010 and more than double the amount from 2018.”<sup>2</sup> The SEC published a notice that during the COVID pandemic it “experienced a significant uptick in tips, complaints, and referrals involving investment scams. The SEC’s Office of Investor Education and Advocacy urges investors to be on high alert in order to protect themselves and others from becoming victims of investment fraud.”<sup>3</sup> Yet, despite an increase in the problem that only frequent

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<sup>1</sup> FINRA, *About FINRA*, <https://www.finra.org/about#:~:text=To%20protect%20investors%20and%20ensure,in%20the%20market%20with%20confidence>. (last visited November 18, 2022).

<sup>2</sup> CNBC.com, *Ponzi schemes hit highest level in a decade, hinting next ‘investor massacre’ may be near*, <https://www.cnbc.com/2020/02/11/ponzi-schemes-hit-the-highest-level-in-10-years.html> (Feb 11, 2020).

<sup>3</sup> SEC, *Investment Scam Complaints on the Rise – Investor Alert*, <https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/investment-0> (December 14, 2020).

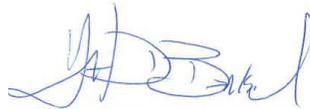
in-person surprise visits would catch, FINRA proposes a rule that will serve to reduce the oversight of remote brokers and would thereby exacerbate the growing problem.

Any provision that weakens the rules as they relate to inspections of home or remote offices is flawed and would likely lead to more harmed investors. These proposed rules (SR-FINRA-2022-019 and SR-FINRA-2022-021) would provide even more ample opportunity 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 as residential and remote offices and virtual technology becomes more prevalent. Additionally, rules that require firms to review more than just a sampling of electronic correspondence would be needed to combat potential problem brokers.

The instant rule proposal states that the Commission will consider any request for an oral presentation pursuant to Rule 19b-4. If the Commission decides to hold a hearing and allow interested parties to present oral argument on the rule proposal, PIABA requests the opportunity to participate in that hearing and present its oral argument.

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

Very Truly Yours,

A handwritten signature in blue ink, appearing to read "H. Berkson".

Hugh D. Berkson  
President, Public Investors Arbitration Bar  
Association