



PUBLIC INVESTORS ADVOCATE BAR ASSOCIATION

1300 McGee Drive, Suite 112 | Norman, OK 73072

Toll Free (888) 621-7484 | Fax (405) 360-2063

www.piaba.org

November 22, 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-2022-019 – Proposed Rule Change to Adopt New Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110

Dear Ms. Countryman:

I write on behalf of the Public Investors 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 ("SEC" or "Commission"), PIABA submits this comment to the SEC concerning FINRA's recent filing with the Commission a proposed rule change to amend FINRA Rule 3110 (Supervision). FINRA has filed proposed changes to FINRA Rule 3110 to add new Supplementary Material as section .19 (3110.19 - Residential Supervisory Location). The proposed amendment would allow a home office to be considered residential supervisory location and then create rules and procedures for the supervision of same.

The proposed rule was initially published for comment on August 2, 2022. PIABA submitted its comment on August 23, 2022, urging the Commission to reject the rule proposal. FINRA then consented to an extension of time through October 31, 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 4, 2022, and PIABA again submits this comment, asking the SEC to reject this proposal.

Officers and Directors

President: Hugh D. Berkson, OH
EVP/President-Elect: Joseph C. Peiffer, LA
Vice President: Adam Gana, NY
Secretary: David P. Neuman, WA
Treasurer: Thomas D. Mauriello, CA

Michael Bixby, FL
Michael Edmiston, CA
Samuel B. Edwards, TX
Robert J. Girard II, CA

W. Scott Greco, VA
Lance McCardle, LA
Timothy J. O'Connor, NY
Darlene Pasieczny, OR

Courtney M. Werning, OH
Joseph Wojciechowski, IL
Robin S. Ringo, *Executive Director*
Jennifer Shaw, *Executive Director*

Background

As a result of the Covid pandemic, regulators eased regulatory requirements to accommodate brokerage firm employees working from home. This effort included the introduction of new technologies to permit remote supervision. By way of this proposal, FINRA appears to be adapting to a new, post-pandemic “blended workforce” model, one in which employees work on-site in traditional offices as well as in their homes. FINRA has noted that “technological advances in surveillance and monitoring capabilities” have enabled greater “workplace flexibility.” This rule change proposal, therefore, is considered a reassessment of “the manner in which firms may effectively and efficiently carry out their supervisory responsibilities considering evolving business models and practices, advances in technology, and regulatory benefits.”

FINRA’s stated intent is to classify some private residences as “non-branch” locations and thereby “align” with procedures already in place (with certain exclusions) for non-traditional methods of supervision. FINRA contends that the elevation of private residences to non-branch status “will not result in a loss of the important regulatory information that the rules were designed, in part, to provide regarding the locations or associated persons.”

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

PIABA submits this comment because the Association believes the amendment is a fundamentally flawed idea and 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 advisors working from home 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 home office, the auditor can see their home, car, and other assets. Many firms’ compliance procedures ask supervisors to gauge whether the advisor is leaving 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.

* * *

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).

Section (a)(3) of the rule proposal provides that a remote location cannot qualify as a “non-branch location” if the broker meets with clients at their remote or home office. However, common sense tells us that the securities industry simply cannot rely on a fraudulent broker to follow the rules in the absence of real oversight. *See NASD v. Robert Joseph Kernweis*, NASD No. C02980024 (Feb. 16, 2000) (finding that supervisors cannot rely on unverified representations of a broker). Likewise, a review of all electronic communications that are made through the member firm’s electronic data systems would only be sufficient if firms are required to adequately review these emails; yet firms commonly review only a small sampling of electronic correspondence. 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’ return to office;
- b) https://www.financialadvisoriq.com/c/3255614/411324/edward_jones_others_add_res_flexibility_needs_amid_return_offices (July 2021) - discussing Edward Jones’ expectation for most employees to 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.

Moreover, it is noteworthy that some of the firms who supported the rule proposal have actually made statements in support of their advisors and staff returning for work. For example, Virtu

Financial submitted a letter in support of the proposal on August 23, 2022. A quick review of Virtu Financial’s website states that “We are developing plans to bring people back to the office, but this will be a cautious and methodical process.”¹ Charles Schwab also submitted a comment supporting the proposal but planned a “sequenced” return to the office, beginning in April 2022.² In short, the argument that the Pandemic-related need to allow associated persons to work from home, and the resulting need to use technological tools to remotely supervise those activities, is no longer compelling as the number of people working remotely 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”³ 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.”⁴ 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.”⁵ Yet, in light of an increase in the problem that only frequent 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

¹ See Virtu Financial’s website at <https://www.virtu.com/about/virtutogether/> (last visited November 16, 2022).

² See Financial Advisor IQ, “Schwab Sets Return for April; Vaccination is Optional”, Feb. 28, 2022, at https://www.financialadvisoriq.com/c/3515434/437874/schwab_sets_office_return_april_vaccination_optional (last visited November 16, 2022).

³ FINRA, *About FINRA*, <https://www.finra.org/about#:~:text=To%20protect%20investors%20and%20ensure,in%20the%20market%20with%20confidence>. (last visited November 18, 2022).

⁴ 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).

⁵ 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).

Ms. Vanessa A. Countryman

November 22, 2022

Page 6

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