



PUBLIC INVESTORS ADVOCATE BAR ASSOCIATION

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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-2023-007 – Proposed Rule Change To Adopt Supplementary Material .18 (Remote Inspections Pilot Program) Under FINRA Rule 3110 (Supervision)

Dear Ms. Countryman:

I write on behalf of the Public Investors Advocate 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"), a proposed rule change to amend FINRA Rule 3110 (Supervision). 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 to 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 under SR-FINRA-2022-021. PIABA submitted its comment on September 6, 2022, urging the Commission to reject the rule proposal. 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

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whether to approve or disapprove the proposal. As such, proposal SR-FINRA-2022-021 was published again on November 16, 2022, where PIABA again asked the SEC to reject this proposal. This proposal was re-published again May 4, 2023. This now appears to be the fourth iteration of the rule proposal.

As PIABA has stated on numerous prior occasions, this rule proposal flies directly in the face of FINRA's stated objective, which is "dedicated to protecting investors." The rule proposal clearly contradicts FINRA's objective.

Background

Beginning many years ago, SEC staff and FINRA have interpreted FINRA rules to require member firms to conduct on-site inspections of branch offices and unregistered offices (i.e., non-branch locations) in accordance with the periodic schedule described under Rule 3110(c)(1).2 FINRA states that over the years, 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.

In its Amendment filing, FINRA, in part, argues:

"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 . . . [stating] 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."

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.

PIABA submits this comment because the bar association believes this proposal and its various amendments, much like the recently proposed amendment .19, to allow a home office to be considered residential supervisory location and creating rules and procedures for the

supervision of same (SR-FINRA-2022-019 and SR-FINRA-2023-006), is also an ill-conceived 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 to skirt the rules and inflict harm on their unsuspecting clients. The amendments made to this rule proposal do not address the significant harm done to investors by rogue brokers working in the absence of adequate supervision.

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.

* * *

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 Ist 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); *In the Matter of Gary Rathbun and Douglas Scott Miller*, FINRA No. No. 2014041919401 (regarding a \$72 million fraudulent scheme sold away at a remote office). Advisors like the those mentioned above, and the too-many-to-count advisors who also engage in selling away not mentioned in this list, are ample reasons to deny this proposal.

The newest 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. But under this rubric, brokers with a substantial number of customer complaints, those under regulatory investigations, those who were terminated for cause, and those who have significant judgments or liens would all be allowed to participate in this pilot program. This leaves a lot of problematic brokers with little oversight.

The latest Amendment to the rule proposal vaguely asks firms to “conduct a risk assessment prior to electing a remote inspection for an office,” setting forth a list of factors to consider. However, the Amendment seems to brush off any concerns by PIABA or NASAA, stating that firms are required to “consider numerous factors in conducting a risk assessment” but leaves this “assessment” up to the brokerage firm’s interpretation. These vague guidelines only set this proposal up for failure, as firms will use every advantage to do the bare minimum as required by the new rules, at the expense of the investing public. Whatever savings the firms enjoy by minimizing supervision will be more than outweighed by the harm unsupervised brokers will inflict. In short: the harmed investors will subsidize the brokerage firms.

Likewise, current surveillance of electronic communications has been insufficient. 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 emails and other electronic communications; 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 two years. 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_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.
- f) <https://www.reuters.com/business/finance/finance-firms-return-to-office-crackdown-could-backfire-study-2023-08-08/> (Aug 2023) – stating that many firms like Morgan Stanley, Goldman Sachs, and JP Morgan have been “prominent advocates” of in-office working;
- g) <https://www.businessinsider.com/companies-making-workers-employees-return-to-office-rto-wfh-hybrid-2023-1> (Jul 2023) - listing numerous major companies requiring in-office work, including Blackrock, Citigroup, Goldman Sachs, JP Morgan, among others.

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 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"¹ 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."² 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."³ 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 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 are needed to combat potential problem brokers.

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

Very Truly Yours,



Hugh D. Berkson
President, Public Investors Advocate Bar
Association

¹ FINRA, *About FINRA*, <https://www.finra.org/about#:~:text=To%20protect%20investors%20and%20ensure,in%20the%20market%20with%20confidence>. (last visited May 5, 2023).

² 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).

³ 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).