



PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION

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January 11, 2018

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, DC 20006-1506
pubcom@finra.org

Re: FINRA Regulatory Notice 17-38: Remote Branch Inspections

Dear Ms. Mitchell:

I write on behalf of the Public Investors Arbitration Bar Association (“PIABA”), an international, not-for-profit, voluntary bar association that consists of attorneys who represent investors in securities and commodities arbitration proceedings. Since its formation in 1990, PIABA’s mission has been to promote the interests of the public investor in by, amongst other things, seeking to protect such investors from abuses in the arbitration process, seeking to make the arbitration process as just and fair as possible, and advocating for public education related to investment fraud and industry misconduct. Our members and their clients have a fundamental interest in the rules promulgated by the Financial Industry Regulatory Authority (hereinafter “FINRA”) that relate to investor protection.

FINRA Regulatory Notice 17-38 seeks comment on proposed amendments to FINRA Rule 3110, which requires FINRA member firms to maintain a system of supervision that is reasonably designed to achieve compliance with FINRA rules and applicable securities laws and regulations. FINRA Rule 3110(c) requires FINRA member firms to review, at least annually, the business in which they engage. FINRA has interpreted this rule to require that inspections take place “on-site.” *See* FINRA Regulatory Notice 11-54 (“A broker-dealer must conduct on-site inspections of each of its office locations.”) (Emphasis added.)

FINRA’s proposal would relieve its member firms of their obligation to conduct annual in person inspections of certain “qualifying” offices, which FINRA has defined as, amongst other things, those with “not more than three associated persons” designated to the location.

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PIABA opposes the proposed amendments to FINRA Rule 3010, as they would significantly weaken the minimum required oversight of a high-risk category of registered representatives. Small, geographically remote branch offices, by their very nature, create significantly heightened opportunities for unscrupulous brokers to engage in a variety of illicit conduct including, but not limited to, unapproved outside business activities and engaging in unapproved private securities transactions (e.g. “selling away”).

The Securities and Exchange Commission (SEC) has repeatedly emphasized that these small remote branch offices require vigilant supervision. For example, SEC Staff Legal Bulletin No. 17 *Remote Supervision* (March 19, 2004) provides:

Some broker-dealer firms have geographically dispersed offices staffed by only a few people, and many are not subject to onsite supervision. Their distance from compliance and supervisory personnel can make it easier for registered representatives (representatives) and other employees in these offices to carry out and conceal violations of the securities laws. The supervision of small, remote offices, therefore, can be especially challenging...

Inspections are a vital component of a supervisory system. The Commission has determined that broker-dealers that conduct business through remote offices have not adequately discharged their supervisory obligations where there are no inspections of those offices. Effective inspections can detect misconduct in its infancy, deter future wrongdoing, and prevent or mitigate investor harm. An effective supervisory system employs a combination of onsite and offsite monitoring, including the use of unannounced inspections and mechanisms for verifying that deficiencies are corrected...

Onsite inspections usually take one of two forms: routine or "for cause." Routine inspections are conducted in the ordinary course of business, while "for cause" inspections are conducted upon learning about a specific event or potential violation. We suggest that all inspections include at least... in-person questioning of the representative by the supervisor about business activities, including inquiry about any unusual activity; and (6) in-person interview by the supervisor of the representative's assistant or support staff, if any, about the remote office's business and any unusual activity. If, during the course of the examinations, deficiencies are identified, examiners should consider the need to conduct a more in-depth review. (Emphasis added.)

The proposed amendments to FINRA Rule 3110 do not address the SEC's well-founded concerns regarding the inherent risks associated with small, geographically remote branch offices with no direct on-site supervision. Electronic inspections will not reveal any of the hallmark indicators of misconduct, such as documents related to unapproved outside businesses or sales literature and marketing materials for unapproved outside investments. These are just a few examples of the types of misconduct which will go undetected with an electronic branch inspection, but would have been easily detected through an in-person inspection.

FINRA itself has repeatedly emphasized the importance of in-person branch inspections. For example, FINRA Regulatory Notice 11-54 provides:

The branch inspection provides the firm with the opportunity to validate its surveillance results from branch offices and to gather on-site intelligence that supplements the ongoing management and surveillance of the branch...

Branch office inspections provide an opportunity for oversight that should enhance the firm's routine surveillance and supervisory activities. For instance, branch office inspections may allow a firm to better identify the nature and extent of outside business activities of registered branch office personnel. Outside business activities conducted by registered persons may carry added risk because these activities may be perceived by customers as part of the member's business. Confirming that the scope of outside business activities of registered branch office personnel conform to those activities authorized by the firm is an important component of the branch office inspection, and addresses a risk that may be more difficult to monitor. For much the same reasons, unannounced inspections (which do not provide an opportunity to hide, alter or destroy documentation or other information reflecting such activities) are a critical element of any well designed branch office inspection program and should constitute a significant percentage of all exams conducted.

FINRA's proposed amendments to Rule 3110 do not address FINRA's stated goals and objectives for effective branch office inspections. For example, FINRA Regulatory Notice 11-54 states that an important component for an in-person branch office inspection is "procedures to uncover use of unauthorized computers or other electronic devices..." The electronic branch office inspections contemplated in Regulatory Notice 17-38 cannot meaningfully address or supervise the use of unauthorized devices at remote branch office locations.

As clearly illustrated above, FINRA and the SEC have repeatedly emphasized the importance of in-person branch inspections, especially in connection with remote branch offices. FINRA, without any explanation, now suggests a serious deviation from the supervisory structure both it and the SEC have strongly promoted in the past. The risks and problems identified by both the SEC and FINRA have not disappeared and there is simply no good reason to modify the current compliance structure. A decision to do so would surely allow these problems to manifest more frequently. It is inexcusable that U.S. investors have been, and continue to be, the victims of Ponzi schemes, selling away, and other illicit conduct occurring at remote branch office locations, which could have been easily detected and prevented through the use of more vigorous in-person branch inspections.

PIABA believes that rather than weakening the oversight of these high risk branch office locations, FINRA require stronger oversight of remote branch office locations by implementing more vigorous in-person branch office inspection requirements.

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PIABA thanks FINRA for the opportunity to comment on this proposal and welcomes the opportunity to have further dialogue on this important issue.

Very truly yours,

A handwritten signature in black ink, appearing to read "Andrew Stoltmann". The signature is fluid and cursive, with a long horizontal stroke at the end.

Andrew Stoltmann
PIABA President