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January 12, 2018

VIA ELECTRONIC MAIL

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506
(pubcom@finra.org)

Re: Regulatory Notice 17-38 (November 13, 2017)

FINRA Requests Comment on a Proposal to Amend Rule 3110 (Supervision) to Provide Firms the Option to Conduct Remote Inspections of Offices and Locations That Meet Specified Criteria

Dear Ms. Mitchell:

The National Society of Compliance Professionals ("NSCP") submits this letter in response to the request by Financial Industry Regulatory Authority, Inc. ("FINRA") for comments on a proposal to amend Rule 3110 to add new Supplementary Material .15 to provide firms with flexibility to conduct remote inspections of certain offices rather than on-site inspections. NSCP is a nonprofit, membership organization with approximately 2,000 members and is dedicated to serving and supporting the compliance professional in the financial services industry in both the U.S. and Canada. To our knowledge, NSCP is the largest organization of securities industry professionals in the U.S. and Canada devoted exclusively to compliance. In light of NSCP's focus on compliance and compliance professionals, our comments will be limited to concerns that impact compliance programs and/or compliance professionals.

NSCP begins its comments by commending FINRA for considering whether, in light of technological advances that increasingly blur the boundaries between physical and virtual presence such that the location at which an activity is performed becomes of less significance with each passing year, the resources used by firms to conduct on-site inspections of certain low risk locations might be better allocated to higher risk activities. NSCP is in favor of the increased flexibility that the proposal would allow and, indeed encourages FINRA to consider whether the proposal's flexibility might be narrower than it should be. NSCP also urges FINRA to question more broadly whether the concept of an inspection process focused on a particular location might be increasingly less relevant to how firms meet their overall supervisory and compliance obligations and whether, as a general matter, a location focused inspection obligation should be the exception rather than the rule.

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NSCP's responses to particular questions posed by FINRA's Regulatory Notice 17-38, which responses follow below, reflect the view of interested NSCP members who provided comments to NSCP in response to the proposal.

***Request for Comment**:*

1. How does the firm currently fulfill its obligations under Rule 3110(c) for those offices or locations at which few associated persons reside and limited or low-risk activities occur? In what way(s) would the use of remote inspections impact the firm's current inspection process or practices?

In light of current FINRA guidance, as set forth at Supplementary Material .13 to FINRA Rule 3110, which creates a "general presumption" of a three-year limit for periodic inspection schedules of non-branch locations, the majority of NSCP's members that provided comments to NSCP generally adhere to a three-year non-branch location examination cycle though it is also aware that some members have established longer periodic inspection schedules in accordance with Supplementary Material .13. Notwithstanding the general cycle for non-branch locations, NSCP's members conduct more frequent visits when warranted consistent with the standards set forth in Supplementary Material .12 of FINRA Rule 3110.

NSCP understands that many of its members would take advantage of the opportunity to use remote, rather than on-site, inspections if permitted. Indeed, several NSCP members took exception to the statement in Regulatory Notice 17-38 that FINRA has interpreted FINRA Rule 3110 to require on-site inspections. As support for such statement, FINRA referenced Regulatory Notice 11-54, which notice offered joint guidance by FINRA and the U.S. Securities and Exchange Commission. While that notice does state "[a] broker-dealer must conduct on-site inspections of each of its office locations", nothing in FINRA Rule 3110(c) or its predecessor NASD Rule 3010(c) specifically requires on-site inspections. Accordingly, the basis for the above statement is unclear. Moreover, NSCP understands that some of its members, in reliance on the requirement in FINRA Rule 3110(c) that a firm's "review shall be **reasonably designed** to assist the member in detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulation, and with applicable FINRA rules" (emphasis added), have already adopted remote, rather than on-site, inspections in situations they consider appropriate.

In any event, NSCP members are still considering how they might conduct remote inspection and, therefore, may be unable to comment specifically on the impact that a remote inspection might have on their current inspection process or practices. For this reason, NSCP thinks it would be helpful for FINRA to provide guidance on what it believes constitutes the minimum requirements of a remote inspection and whether firm level oversight of supervisory processes, rather than a location-by-location review, might be deemed to satisfy the inspection requirement in whole or in part.

Notwithstanding these uncertainties, some members believe that in light of the reduced travel and other costs associated with a remote inspection, they would be likely to increase the frequency of remote inspections as compared to on-site inspections. That said, there is unlikely to

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be a one-size-fits-all solution for all NSCP members such that it can be expected that some members might opt for increased frequency of remote inspections while other members may conclude that the current three year or longer schedule continues to make sense notwithstanding that inspections would be conducted remotely. We believe that the risks associated with the business conducted, the manner in which it is conducted, the risk profile of the persons engaging in the business and prior exam findings, among other factors, should be the drivers for frequency of exam, rather than whether the prior exam was conducted remotely.

2. Should a firm with a disciplinary history of supervisory violations or other investment- related violations be able to avail itself of the option to conduct remote inspections?

NSCP is opposed to a blanket policy prohibiting use of remote inspections based upon a firm history of supervisory or other investment-related violations. More specifically, NSCP does not think a one-size-fits-all policy would be fair or reasonable. For example, a supervisory failure related to capital calculation should have no bearing on a firm's ability to conduct a meaningful remote inspection. Similarly, isolated and remediated violations, e.g., ones that involve one or two individuals or one or two instances in a large firm with many locations and representatives, would not, by themselves, be relevant to a firm's ability to conduct a remote inspection. Instead, firms should be reminded that, as outlined in Supplemental Material .12 to FINRA Rule 3110, the presence of prior violations is a factor that firms should consider when planning their inspection program.

3. Are there other criteria for a "qualifying office" that should be considered? For example:

a. The proposal requires a firm to determine whether a remote inspection of a qualifying office would be reasonable by considering the factors set forth under Rule 3110.12 including the volume of business. Should a threshold be imposed on the volume of business generated from the qualifying office, or should offices that are responsible for a significant proportion of a firm's business be excluded from the definition?

Again, NSCP does not believe that a one-size-fits-all approach is fair or reasonable with respect to setting a threshold for whether a location is included in the "qualifying office" definition. For example, for many firms, large commission volumes relating to highly sophisticated institutional clients may present less concern than lower volume retail business. At other firms, the risk profile could be reversed (for example, if the institutional business involves low priced securities, or if the supervisory staff in the institutional business is less experienced.) Similarly, a threshold that uses a test based upon a proportion of a firm's business conducted from a particular office, is likely to have a disproportionate impact on small firms with fewer offices with the result that like locations may be treated differently depending upon the size of a firm or its office structure. FINRA has routinely asserted that what constitutes appropriate supervision and compliance is based on the facts and circumstances, and that adage applies here as well.

More generally, a number of members thought that FINRA's proposed definition of a "qualified office" is too narrow and restrictive and would effectively exclude most branch offices

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thereby limiting the efficacy of the proposed rule. Firms also expressed the view that the existing risk-based approach prescribed by Supplement Material .12 to FINRA Rule 3110 already offers an appropriate approach for firms to decide if an office should be inspected on-site or remotely. Accordingly, instead of amending Rule 3110 as proposed, these firms suggest that FINRA offer additional guidance that specifically acknowledges that inspections may be conducted remotely if doing so would be reasonable.

In short, firms should be left to make their own risk-based determination after carefully considering the relevant facts and circumstances with respect to each location.

b. Should there be a prerequisite that a firm must have conducted an on-site inspection of an office or location before such office or location could become a qualifying office?

While a prior on-site inspection may be one of many factors that firms should consider before designating a location for a remote inspection, NSCP again believes that it should not be a requirement. Doing so would undermine much of the efficiency that FINRA is seeking to achieve through the proposal. Instead, NSCP believes that firms should be given the flexibility to designate a location as subject to a remote inspection based upon the firm's careful risk-based consideration of all of the relevant facts and circumstances of which a prior on-site inspection is just one of many.

c. Should the firm be required to conduct an interview with the associated person(s) designated to the qualifying office by video conference or in-person at any mutually agreed upon office or location?

NSCP believes that the benefits of a remote office inspection would be largely lost to the extent an in-person meeting was required. As to a video conference interview requirement, NSCP recognizes that this will often be a valuable component of an exam. However, there are many types of offices, such as where back office operations are conducted and there are regular communications with compliance personnel, in which this would be superfluous. Once again, firms should be able to conduct exams so that they are meaningful. If a formal video conference would not add value, it should not be required.

d. Should there be a minimum distance between the qualifying office and the OSJ or supervisory branch office?

Please provide specific thresholds and the underlying rationale for the thresholds.

While distance between the qualifying office and the OSJ or supervisory branch office likely is relevant to the level of expense associated with the conduct of an on-site inspection, it is only one factor among many and should not be determinative. Indeed, NSCP believes that its members do not typically consider the expenses associated with an on-site inspection as part of their risk-based determination of whether an inspection is required and believes it would set a bad precedent for FINRA to explicitly memorialize distance and, therefore, expense as factors in determining whether to conduct on-site inspections. Moreover, basing the on-site inspection

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requirement on distance ignores the underlying rationale for allowing remote inspections in the first place, namely that technology is increasingly doing away with the need for an on-site presence regardless of distance.

4. The proposal seeks to limit the number of associated persons designated to a qualifying office to three. Is this threshold reasonable? If not, why not? Is there a more appropriate threshold and why?

Please provide a specific threshold and the underlying rationale for the threshold.

The number of associated persons designated to a qualifying office is just one factor and should not be determinative as to whether an office is designed a qualifying office. For example, a cluster of operations personnel who are not client facing nor have access to checks or securities often would be very low risk and may not warrant an on-site inspection, regardless of whether the location consists of three, five or more such individuals. For this reason, most members felt that more flexibility would be useful and that firms should be able to set their own thresholds based upon their careful, risk-based consideration of all the relevant facts and circumstances. If it is necessary to specify a threshold, one member suggested the threshold should be three “registered” persons rather than “associated” persons.

5. Are there criteria for a qualifying office that should be excluded?

Several members questioned the need for any inspection requirement, whether on site or remote, with respect to locations excluded from the branch office definition by paragraph (f)(2)(A)(i) – (vii) of Rule 3110 and for non-client facing functions where the persons engaged in such activities can be subject to remote supervision on an ongoing basis. In particular, our members’ collective experience is that there is little or no reason to inspect offices of convenience and temporary offices, whether on-site or remotely. Several members also commented that inspections of home offices were generally an inefficient use of time and money and that, while a remote inspection of a home office might be less burdensome, it would still be an inefficient use of time. Similarly, back office and other non-client facing functions may not require inspections as it is frequently the case that the activity in which the non-client facing associated persons are engaged can be supervised remotely on an ongoing basis and that there is little or no value in an additional inspection, whether on-site or remote. By way of example, it is difficult to see the added benefit of an inspection of a back office staffed by a compliance officer charged with keeping procedures up to date. Presuming, in such case, that the firm has processes for reviewing the draft procedures, it is difficult to see the need for an on-site or remote inspection of the compliance officer’s remote office. The same would be true of an associated person who writes code for a firm’s trading systems as well as for the many activities that can be appropriately reviewed with little or no benefit being gained by an added inspection of the location. In such cases, NSCP believes that the day-to-day supervisory function, together with oversight of that function, is far more important as a general matter than a periodic inspection process focused on a particular location. A firm would always retain the responsibility to inspect any of its locations if facts and circumstances dictate.

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6. Does the proposal have any potential negative impacts on a firm's ability to fulfill its obligations under Rule 3110(c)?

The proposal does not seem to have a negative impact on a firm's ability to fulfill 3110(c) obligations.

7. Are there any material economic impacts, including costs and benefits, to investors, issuers and firms that are associated specifically with the proposal? If so:

a. What are these economic impacts and what are their primary sources?

Firms would realize cost savings by virtue of not incurring travel and lodging expenses. Presumably, these cost savings would either be used elsewhere in a firm's compliance and supervisory programs, and ultimately may lower the cost of services to investors and issuers, or as increased compensation for the registered representatives or the firm's owners.

b. To what extent would these economic impacts differ by business attributes, such as size of the firm or differences in business models?

The economic impact of the proposal would vary by the number and proportion of qualifying offices. Some firms are likely to see little benefit whereas the proposal could have a very significant impact on other firms. The proposal could also lead to more flexibility among firms as to their willingness to allow non-branch locations.

c. To what extent would these economic impacts affect existing business models and existing organizational structures?

Any rule change that reduces the costs associated with supporting a qualifying office is likely to encourage adoption of such offices. In addition, these reduced costs could also encourage firms to be more flexible in their approval of remote working arrangements, which could be of benefit to both firms and their associated persons.

d. What would be the magnitude of these impacts, including costs and benefits (e.g., travel, infrastructure, human resources)?

Obviously, there would be a great deal of variability among firms in such costs, which makes it difficult for NSCP to provide estimates of the possible savings. That said, in some cases, on-site office inspections can easily exceed $1,000 per office, not including the cost of time away from the office. In addition, firms that engage compliance consultants to conduct on-site examinations, would be able to avoid such fees entirely.

8. Are there any expected economic impacts associated with the proposal not discussed in this Notice? What are they and what are the estimates of those impacts?

NSCP members did not identify any additional economic impacts.

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We commend FINRA for giving us this opportunity to present our views on FINRA's proposal to allow for remote inspections of qualifying offices. NSCP would welcome the opportunity to answer any follow-up questions that FINRA may have on this submission or to provide such further assistance as FINRA may request.

Thank you for your attention to these comments. Questions regarding the foregoing should be directed to the undersigned at (860) 672-0843.

Sincerely,

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