



NASAA

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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By email to pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 20-42: Retrospective Rule Review – FINRA Seeks Comment on Lessons from the COVID-19 Pandemic

Dear Ms. Mitchell:

On behalf of the North American Securities Administrators Association (“NASAA”),¹ I submit the following comments regarding the above-referenced regulatory notice (the “Notice”)² issued by the Financial Industry Regulatory Authority (“FINRA”) on December 16, 2020.

NASAA appreciates the opportunity to provide comments regarding potential responses to the COVID-19 pandemic well before any changes are proposed to FINRA’s rules. The opportunity for pre-proposal dialogue is especially important here, given that the pandemic is ongoing and registrants and regulators are still learning how to operate remotely. While it is valuable to gather insights now and to consider whether changes to regulations are needed, NASAA believes that some proposals may not be ripe for consideration until the facts can be reviewed in hindsight following the pandemic, or until a new normal emerges more clearly. Accordingly, NASAA’s comments below are offered to begin conversations on these matters and we encourage FINRA to engage with us early in any efforts to evaluate any changes to existing rules, forms and processes.

¹ Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

² The Notice is available at <https://www.finra.org/rules-guidance/notices/20-42>.

I. Business Continuity Planning

The Notice asks whether FINRA should “consider any amendments to Rule 4370 to address issues raised during the pandemic.”³ NASAA appreciates that Rule 4370 is a principles-based rule not intended to address every circumstance. Nevertheless, we believe that certain additions to the criteria listed in Rule 4370(c) may be warranted.

Previous disruptions – both experienced and foreseen – have been temporary or limited geographically. Commonly understood business continuity events include office fires, electrical outages, or weather-related disasters like hurricanes. The pandemic is different from these examples because it has been widespread and long-lasting. It has forced many firms to operate remotely for extended periods, and it has caused widespread investor anxiety and economic hardship. As one particularly relevant example, NASAA is aware of instances where customers complained of not being able to reach call-in center support or access their accounts. Finally, overhanging all of these issues is the staggering toll the pandemic has taken on Americans’ health and well-being.

Because the pandemic has presented a business continuity event different in kind from previous events, FINRA should consider adding criteria that address sustained and catastrophic disruptions. NASAA suggests criteria such as: gathering, handling and maintaining records generated outside of firm systems; providing long term secure remote access to firm systems; creating rapid succession plans for lost principals and employees; re-establishing and maintaining contact with customers; handling unexpected surges in business; and alternative procedures for supervising employees. Finally, depending on the number, depth and utility of responses, NASAA also suggests that FINRA consider publishing an analysis regarding which aspects of firm business continuity plans worked well, and which did not, to help firms strengthen their plans going forward.

II. Remote Offices, Alternative Work Arrangements and Remote Inspections

NASAA understands that the current sustained period of teleworking may result in wider changes to employment practices. However, the promise of a fully dispersed and electronic future workplace should be tempered by the reality of the last year. We have all likely experienced teleconference nightmares, dropped calls and service outages. We have all likely seen colleagues working as best they can from basements and kitchen tables with pets and children wandering in the background. Any success we have experienced in teleworking over the last year is as much a testament to our collective personal resilience as it is to the power of technology. Further, because examinations and inspections have also been hampered by the pandemic, it is premature to conclude that remote operations are generally being conducted in compliance with regulations.

³ Notice at 7.

When viewed soberly and in hindsight through this retrospective rule review, FINRA should recognize the apparent shortcomings of work-from-home arrangements that would have to be addressed in order to make widely disbursed brokerage services safe from a regulatory perspective. Many homes have weak cybersecurity and are not secure places to store physical records. The risks of data loss and the challenges of data recovery are higher for remote workers. Firms also have no control over who is present in a home office. Any discussion of allowing firms and associated persons to custody customer securities or funds in home offices should therefore be viewed skeptically. Further, the likelihood of representatives communicating with customers outside of firm systems is much greater. In short, home offices are not controlled settings in the way that business offices are and, unless and until regulatory controls are developed to account for those shortcomings, it would be unwise to make current accommodations permanent.

The approach of state regulators has been to make temporary and limited accommodations that can be reimposed when circumstances allow or when the need arises. For instance, in response to the pandemic a number of states ordered temporary relief to allow persons displaced from their offices to conduct business in jurisdictions other than those in which they are registered.⁴ Most state orders made clear, however, that the accommodation was temporary, and that a registrant working outside of his or her registered jurisdiction could not solicit new customers in that jurisdiction. This relief was constructed carefully to allow registrants to continue to work without interruption, but not to allow the pandemic to lead to an easing of regulatory requirements generally or to otherwise diminish robust investor protections.

As we continue to monitor progress in combatting the pandemic, state regulators are evaluating when, whether and how to limit or end extraordinary relief. For instance, no matter whether the pandemic eases or whether current conditions linger, the exigencies that led states to grant temporary registration relief – often in the wake of state “shelter in place” orders – will subside. State regulators will begin to expect that all registrants operating within their jurisdictions become licensed in those jurisdictions. The Notice states that “some member firms have indicated an interest in continuing to allow use of remote offices or alternative work arrangements by some personnel after the pandemic.”⁵ If so, firms inclined to allow their employees to keep working from home should begin acting now – before regulatory grace expires – to ensure that those employees are registered in the jurisdictions from which they are working. FINRA can help by reminding firms who allow employees to work remotely to ensure that those employees are licensed properly.

The Notice also asks whether the definitions of branch office and Office of Supervisory Jurisdiction under FINRA Rule 3110 should be changed to reflect the wider adoption of telework.⁶ NASAA does not believe they should without a full vetting of the circumstances

⁴ See, e.g., West Virginia Securities Division, Emergency Order, *In re Temporary Relief for Registrants Affected by the COVID-19 Outbreak* (Mar. 23, 2020), available at <https://www.nasaa.org/wp-content/uploads/2020/03/EMERGENCYORDERCOVID1932320.pdf>.

⁵ Notice at 6.

⁶ See *id.* at 6 and 8.

under which more lenient definitions can be abused or lead to risks to investors. The definitions serve to determine where and how supervision should occur and where inspections should be required, regardless of whether those events occur in office or home settings, and regardless of whether they occur in disparate jurisdictions. The desire to increase the use of remote offices and alternative work arrangements does not change the regulatory reasons behind the definitions. Any contemplated change to the FINRA definitions should be discussed with state regulators in depth before any proposal is made in part because state regulations are in some cases designed to follow them, and unexpected consequences that harm registrants can follow from regulatory confusion.⁷

As FINRA recognizes, allowing firm employees to work remotely creates inspection challenges. FINRA and state regulators have responded to those challenges during the pandemic by waiving certain inspection requirements temporarily. That certainly makes sense when an on-site inspection can endanger the health of everyone involved. Some firms have purportedly indicated to FINRA that they would like to see such relief made permanent.⁸

To be clear, state regulators believe that such a wholesale change to the onsite inspection regime would be a bad idea. Inspections are necessary to compel compliance.⁹ A firm's decision to operate remotely does not relieve that need. Further, given the insecure nature of home offices, it would not be sufficient to allow registrants simply to certify that they are acting in compliance. If anything, dispersed operations may exacerbate the need for inspections because supervision becomes more challenging.

In a world of remote work, the regulatory burdens on FINRA and state regulators could increase. Whether conducted centrally or remotely, regulators need to have confidence that firms and their employees are following the law. In some cases, that will mean that remote locations must be inspected physically. It is the experience of regulators that certain failures – such as recordkeeping, cybersecurity, and outside business activities – can escape notice in remote inspections. Indeed, a handful of states believe that on-site inspections are so important that they require all branches to be inspected in person annually.

While the Notice does a good job of posing questions to better understand the flexibility and changes that industry may be seeking, it does not adequately consider the concerns investors may have when their brokers work at home with minimal supervision. For instance, investors may be concerned about whether a registrant shares his or her home office with others, the security of personal information, and whether conversations about sensitive personal information

⁷ In particular, Form BR – which is used to register branch offices – is used by both FINRA and some state regulators. Any changes to this form, which was developed jointly with NASAA's CRD/IARD Steering Committee, will have to be coordinated to ensure that any regulatory changes do not have unexpected consequences for states that also use the form.

⁸ See Notice at 6.

⁹ Firms may comment that onsite inspection programs reveal few, if any, deficiencies. The fact that a firm's onsite inspections turn up only a few problems is a testament to the success of such programs and not a reason to eliminate them.

are in fact private. Further, firms and regulators need to ask themselves how they can be assured that registrants prevent unregistered persons, or persons with disciplinary histories, to have access to customer information. Without good answers to such questions, regulatory changes cannot be justified.

Another issue that would have to be addressed is how heightened supervision can occur remotely, and whether it should be allowed. Unfortunately, some registered representatives do need to have supervisors looking over their shoulders. When many states place a registered representative on heightened supervision, they require that person to sit in a branch office with an on-site supervisor. That is not possible when the representative is working from home.

Last, while the Notice operates from a presumption that remote work has been a success, and therefore asks whether remote supervision and inspection could also succeed, state regulators have found cases where registrants have not been sophisticated enough to respond to remote examination requests. In other words, they do not know how to send records electronically. Not everyone who works in the financial services industry is technologically savvy, well-equipped, or supported by staff with extensive technology resources. Therefore, despite the dangers, state regulators have conducted a small number of examinations in person during the pandemic.

III. Qualification Examinations

The Notice asks whether FINRA should “consider retaining or expanding online delivery of qualification exams after the pandemic.”¹⁰ Whether to retain or expand online examinations are two separate questions.

NASAA believes that online delivery of qualification examinations should be retained in some form. As the Notice points out, FINRA and NASAA worked together to offer FINRA’s Securities Industry Essentials (SIE), Series 6, and Series 7 exams and NASAA’s Series 63, Series 65 and Series 66 exams remotely. Developing that capability was the result of thousands of hours of work, and the cooperative efforts of FINRA, NASAA, Prometric LLC, and a collection of firms who served as early testers of the functionality. The Notice also points out that examination windows were extended to accommodate candidates unable to visit physical test centers. That problem is ongoing and could happen again. The ability to deliver examinations online is a business continuity measure for FINRA and NASAA that should remain available to ensure that the financial services industry functions smoothly. It also is reasonable to believe that online testing would remain as an accommodation for candidates who cannot travel to a testing center.

However, whether and how online examinations remain available beyond present business continuity needs and future accommodation needs is still to be determined. The primary concern is test security. Although steps have been taken to prevent cheating and to catch those who do cheat, the unfortunate reality is that some candidates cheat during examinations. Proctoring in physical test centers is a well-developed process informed in part by

¹⁰ Notice at 9.

the ways in which candidates have attempted to cheat in the past. Although serious time and effort is being devoted to make online proctoring effective, it is less well-developed and the ways in which candidates can cheat online are still being ascertained.

As things stand now, online examinations serve a need, and the risks of online testing have been evaluated in light of that need. However, the benefits of online testing will need to be evaluated stringently against the risks of online cheating, especially in light of successful measures to combat the pandemic. Further, there is currently a world-wide infrastructure of physical test centers, staffed by experienced proctors, that should not be discarded lightly. NASAA also believes there is sufficient capacity between physical test center re-openings and the availability of online appointments to satisfy testing needs,¹¹ and accordingly there should no longer be any need to extend the time within which a qualification examination must be taken.

NASAA understands the potential advantages of online testing; it may be less expensive for firms and easier for their employees to take examinations online. The costs of cheating, however, are severe. A successful cheater is likely unqualified from a skills perspective, and is certainly unqualified ethically and regulatorily from handling investor funds. The unknown extent to which online examinations can allow cheaters to become registered is a threat to investors and the firms that employ them that needs to be fully understood and contained as much as possible before it is appropriate to consider expanding remote testing generally.

IV. Conclusion

FINRA should be lauded for considering whether and how the pandemic has affected the effectiveness of its rules. We appreciate FINRA's thoughtful retrospective rule review. NASAA looks forward to continued dialogue on this topic, with the understanding that investor protection concerns need to be satisfied before regulations can be changed for the sake of convenience.

Thank you for considering our views. Should you have any questions, please contact the undersigned at lisa.hopkins@wvsao.gov, or Vince Martinez, NASAA's General Counsel, at vlm@nasaa.org.

Sincerely,



Lisa Hopkins
NASAA President
General Counsel and Senior Deputy
Commissioner of Securities, West Virginia

¹¹ NASAA recognizes that there have been challenges in scheduling online appointments, but we understand that capacity has improved.