

it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule change should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### *Electronic Comments*

- Use the Commission's internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2020-38 on the subject line.

##### *Paper Comments:*

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.
- All submissions should refer to File Number SR-ISE-2020-38. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish

to make available publicly. All submissions should refer to File Number SR-ISE-2020-38, and should be submitted on or before December 15, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

**J. Matthew DeLesDernier,**  
*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-90454; File No. SR-FINRA-2020-040]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Adopt Temporary Supplementary Material .17 (Temporary Relief To Allow Remote Inspections for Calendar Year 2020 and Calendar Year 2021) Under FINRA Rule 3110 (Supervision)

November 18, 2020.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 6, 2020, the Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by FINRA. FINRA has designated the proposed rule change as constituting a "non-controversial" rule change under paragraph (f)(6) of Rule 19b-4 under the Act,<sup>3</sup> which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt temporary Supplementary Material .17 (Temporary Relief to Allow Remote Inspections for Calendar Year 2020 and Calendar Year 2021) under FINRA Rule 3110 (Supervision) to provide member firms the option, subject to specified requirements under the proposed

supplementary material, to complete remotely their calendar year 2020 and calendar year 2021 inspection obligations under FINRA Rule 3110(c) (Internal Inspections), without an on-site visit to the office or location.<sup>4</sup> The temporary rule change is necessitated by the compelling health and safety concerns and the operational challenges member firms are facing due to the sustained COVID-19 pandemic.<sup>5</sup>

Below is the text of the proposed rule change. Proposed new language is italicized; proposed deletions are bracketed.

\* \* \* \* \*

#### 3000. Supervision and Responsibilities Relating to Associated Persons

##### 3100. Supervisory Responsibilities

##### 3110. Supervision

(a) through (f) No Change

##### • • • Supplementary Material

.01 through .16 No Change

.17 *Temporary Relief To Allow Remote Inspections for Calendar Year 2020 and Calendar Year 2021*

(a) *Use of Remote Inspections. Each member obligated to conduct an inspection of an office of supervisory jurisdiction, branch office or non-branch location in calendar year 2020 and calendar year 2021 pursuant to, as applicable, paragraphs (c)(1)(A), (B) and (C) under Rule 3110 may, subject to the requirements of this Rule 3110.17, satisfy such obligation by conducting the applicable inspection remotely, without an on-site visit to the office or location. In accordance with Rule 3110.16, inspections for calendar year 2020 must be completed on or before March 31, 2021 and inspections for*

<sup>4</sup> SEC staff and FINRA have stated in guidance that inspections must include a physical, on-site review component. See SEC National Examination Risk Alert, Volume I, Issue 2 (November 30, 2011) and *Regulatory Notice* 11-54 (November 2011) ("Notice 11-54") (joint SEC and FINRA guidance stating, a "broker-dealer must conduct on-site inspections of each of its office locations; Office of Supervisory Jurisdictions ("OSJs") and non-OSJ branches that supervise non-branch locations at least annually, all non-supervising branch offices at least every three years; and non-branch offices periodically.") (footnote defining an OSJ omitted). See also SEC Division of Market Regulation, Staff Legal Bulletin No. 17: Remote Office Supervision (March 19, 2004) ("SLB 17") (stating, in part, that broker-dealers that conduct business through geographically dispersed offices have not adequately discharged their supervisory obligations where there are no on-site routine or "for cause" inspections of those offices).

<sup>5</sup> The proposed rule change will automatically sunset on December 31, 2021. If FINRA seeks to extend the duration of the temporary proposed rule beyond December 31, 2021, FINRA will submit a separate rule filing to further renew the temporary relief.

<sup>12</sup> 17 CFR 200.30-3(a)(12).

<sup>15</sup> U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

calendar year 2021 must be completed on or before December 31, 2021. Notwithstanding Rule 3110.17, a member shall remain subject to the other requirements of Rule 3110(c).

(b) *Written Supervisory Procedures for Remote Inspections.* Consistent with a member's obligation under Rule 3110(b)(1), a member that elects to conduct each of its calendar year 2020 or calendar year 2021 inspections remotely must amend or supplement its written supervisory procedures to provide for remote inspections that are reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with applicable FINRA rules. Reasonably designed procedures for conducting remote inspections of offices or locations should include, among other things: (1) A description of the methodology, including technologies permitted by the member, that may be used to conduct remote inspections; and (2) the use of other risk-based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.

(c) *Effective Supervisory System.* The requirement to conduct inspections of offices and locations is one part of the member's overall obligation to have an effective supervisory system and therefore, the member must continue with its ongoing review of the activities and functions occurring at all offices and locations, whether or not the member conducts inspections remotely. A member's use of a remote inspection of an office or location will be held to the same standards for review as set forth under Rule 3110.12. Where a member's remote inspection of an office or location identifies any indicators of irregularities or misconduct (i.e., "red flags"), the member may need to impose additional supervisory procedures for that office or location or may need to provide for more frequent monitoring of that office or location, including potentially a subsequent physical, on-site visit on an announced or unannounced basis when the member's operational difficulties associated with COVID-19 abate, nationally or locally as relevant, and the challenges a member is facing in light of the public health and safety concerns make such on-site visits feasible using reasonable best efforts. The temporary relief provided by this Rule 3110.17 does not extend to a member's inspection requirements beyond calendar year 2021 and such inspections must be

conducted in compliance with Rule 3110(c).

(d) *Documentation Requirement.* A member must maintain and preserve a centralized record for each of calendar year 2020 and calendar year 2021 that separately identifies: (1) All offices or locations that had inspections that were conducted remotely; and (2) any offices or locations for which the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in Rule 3110.17(c). A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection.

\* \* \* \* \*

## II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

On March 13, 2020 the United States declared a national emergency in response to the pandemic.<sup>6</sup> Around this time, many states issued stay-at-home orders and imposed restrictions on businesses, social activities, and travel to slow the spread of COVID-19 and reduce the burden on the U.S. health care system in accordance with the recommendations of public health experts.<sup>7</sup> In response, like many

<sup>6</sup> See Centers for Disease Control and Prevention ("CDC"), International Classification of Diseases, Tenth Revision, Clinical Modification, <https://www.cdc.gov/nchs/data/icd/Announcement-New-ICD-code-for-coronavirus-3-18-2020.pdf>. See also WHO Director-General, Opening Remarks at the Media Briefing on COVID-19 (March 11, 2020), <https://www.who.int/dg/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020>.

<sup>7</sup> See S.J. Lange et al., Potential Indirect Effects of the COVID-19 Pandemic on Use of Emergency Departments for Acute Life-Threatening Conditions—United States, January–May 2020, *Morbidity and Mortality Weekly Report* (June 26, 2020), <https://www.cdc.gov/mmwr/volumes/69/wr/mm6925e2.htm>.

employers across the U.S., member firms closed their offices to the public, transitioned their employees to telework arrangements to comply with stay-at-home orders, and implemented other restrictive measures in an effort to slow the spread of COVID-19 such as curtailing or eliminating non-essential business travel, and significantly limiting or canceling in-person activities.<sup>8</sup> These pandemic-related operational changes have made it impracticable for member firms to conduct the on-site inspection component of Rule 3110(c) at many or most locations for calendar year 2020 because this compliance function requires firm employees to travel to geographically dispersed OSJs, branch offices, and non-branch locations. Such travel not only has been restricted at times by government orders, but also puts the health and safety of employees at great risk of contracting and spreading COVID-19.<sup>9</sup> By mid-year, with many restrictive measures still in place, and in some instances additional quarantine requirements imposed on interstate travel, on-site inspections of offices or locations scheduled for calendar year 2020 continued to remain in abeyance.<sup>10</sup> In recognition of the logistical challenges firms were facing at that time to satisfy the on-site regulatory component of Rule 3110(c), FINRA adopted Rule 3110.16 (Temporary Extension of Time to Complete Office Inspections), extending the time by which member firms must complete

<sup>8</sup> See generally *Regulatory Notice 20–16* (May 2020) ("Notice 20–16") (describing practices implemented by firms to transition to, and supervise in, remote work environment during the COVID-19 pandemic).

<sup>9</sup> See CDC, *Travel During the COVID-19 Pandemic* (stating in part, "Travel increases your chance of getting and spreading COVID-19. Staying home is the best way to protect yourself and others from COVID-19."), <https://www.cdc.gov/coronavirus/2019-ncov/travelers/travel-during-covid-19.html> (updated October 21, 2020).

<sup>10</sup> See, e.g., Government of the District of Columbia, *Phase Two* (June 22, 2020) (announcing certain businesses to reopen and activities to resume under specified conditions and stating that anyone coming into Washington, DC from states specified as high-risk is required to self-quarantine for 14 days), <https://coronavirus.dc.gov/phasetwo> (last visited November 6, 2020); New York Department of Health, *Interim Guidance for Quarantine Restrictions on Travelers Arriving in New York State Following Out of State Travel* (November 3, 2020), available at <https://coronavirus.health.ny.gov/covid-19-travel-advisory> (last visited November 6, 2020); and Chicago Department of Public Health, *Emergency Travel Order* (issued July 2, 2020) (directing travelers entering or returning to Chicago from specified states experiencing a surge in new COVID-19 cases to quarantine for a 14-day period from the time of last contact within the identified state), <https://www.chicago.gov/city/en/sites/covid-19/home/emergency-travel-order.html> (updated October 27, 2020).

their calendar year 2020 inspection obligations under Rule 3110(c) to March 31, 2021, but emphasizing that the extension of time did not relieve firms from conducting the on-site portion of the inspections of their OSJs, branch offices, and non-branch locations.<sup>11</sup>

The acute health and safety concerns related to COVID-19 persist, with the number of confirmed cases of COVID-19 in the U.S. continuing to rise since March 13, 2020.<sup>12</sup> While firms have continued to supervise OSJs, branch offices, and non-branch locations by, among other things, implementing remote supervisory practices through novel uses of technology as well as existing methods of supervision (e.g., supervisory checklists, surveillance tools, incident trackers, email review, and trade exception reports),<sup>13</sup> firms are still experiencing logistical challenges related to conducting the on-site portion of their inspections due to continuing business and governmental restrictions and public health concerns.<sup>14</sup>

Based on feedback described in Notice 20-16, in comment letters submitted in response to File No. SR-FINRA-2020-019,<sup>15</sup> and through recent discussions with FINRA's advisory committees and other industry representatives, FINRA understands that since approximately March 2020, many firms have suspended the on-site component of their inspections scheduled for calendar year 2020. With no certainty as to when pandemic-related health concerns and restrictions will subside, firms will have a considerable backlog of 2020 inspections that may be difficult, if not impossible, to overcome on or before March 31, 2021, even if restrictions are lifted sometime between now and then. Moreover, FINRA recognizes that planning on-site inspections for calendar year 2021 for OSJs, branch offices, and non-branch locations in the current environment may now be

impacted as well. In light of pandemic-related developments, including those since the adoption of Rule 3110.16, and the approaching end of year 2020, FINRA believes further sensible and tailored temporary relief is warranted for member firms to meet their inspection obligations under Rule 3110(c) for calendar years 2020 and 2021.

Proposed Supplementary Material .17 to Rule 3110

In order to proactively address these concerns, FINRA is proposing to adopt temporary Supplementary Material .17. Temporary proposed Supplementary Material .17 would provide member firms, subject to specified requirements therein, the option to conduct remotely the inspections of their OSJs, branch offices, and non-branch locations for calendar year 2020 and calendar year 2021, without the requirement to conduct an on-site visit to such office or location. As described further below, proposed Rule 3110.17 would set forth the dates by which inspections for calendar years 2020 and 2021 are due, the requirement to amend or supplement written supervisory procedures for remote inspections, the use of remote inspections as part of an effective supervisory system, and documentation requirements. FINRA believes this temporary remote inspection option is a reasonable alternative to provide to firms to fulfill their Rule 3110(c) obligations during these pressing times, and is designed to achieve the investor protection objectives of the inspection requirements under these unique circumstances.

The responsibility of firms to supervise their associated persons is a critical component of broker-dealer regulation.<sup>16</sup> The temporary proposed supplementary material is not intended to alter this core responsibility, embodied in Rule 3110, to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. The advent of technology and automation in the financial industry has significantly changed the way in which members and their associated persons conduct their business, communicate, and meet their regulatory obligations. FINRA recognizes that firms generally use an array of technological tools to facilitate their supervisory practices (e.g.,

surveillance systems; electronic tracking programs or applications; electronic communications, including video conferencing tools), which many firms have leveraged to create and implement remote inspection plans, on a temporary basis, in response to pandemic-related operational challenges.<sup>17</sup> FINRA believes that proposed Rule 3110.17 would provide a sensibly tailored regulatory alternative for firms to fulfill their obligations under Rule 3110(c) that would not materially diminish, and is reasonably designed to achieve, the investor protection objectives of the inspection requirements under these unique circumstances. FINRA further notes that the proposed relief would be limited in duration to align with the extended dates set forth under Rule 3110.16 of March 31, 2021 for calendar year 2020 inspections and December 31, 2021 for calendar year 2021 inspections.<sup>18</sup>

A. Deadlines To Complete Calendar Year 2020 Inspections and Calendar Year 2021 Inspections (Proposed Rule 3110.17(a))

Currently, Rule 3110(c)(1) provides that an inspection of an office or location must occur on a designated frequency, and the periodicity of the required inspection varies depending on the classification of the location or the nature of the activities that take place. OSJs and supervisory branch offices must be inspected at least annually (on a calendar-year basis); non-supervisory branch offices, at least every three years; and non-branch locations, on a periodic schedule, presumed to be at least every three years.<sup>19</sup> Under Rule 3110.16, firms have until March 31, 2021 to complete their calendar year 2020 inspections in accordance with the current requirements of Rule 3110(c) that include physical, on-site inspections.<sup>20</sup>

Proposed Rule 3110.17(a) would provide that a member firm that is obligated to conduct an inspection of an OSJ, branch office or non-branch location in calendar year 2020 and calendar year 2021 pursuant to the applicable periodicity set forth under

<sup>11</sup> See Securities Exchange Act Release No. 89188 (June 30, 2020), 85 FR 40713 (July 7, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-019) (stating, among other things, that FINRA will consider whether additional relief may be warranted to address any backlog of 2020 inspections that may continue to exist in light of ongoing public health and safety concerns).

<sup>12</sup> See Johns Hopkins, Coronavirus Resource Center, COVID-19 Dashboard by the Center for Systems Science and Engineering at Johns Hopkins University, <https://coronavirus.jhu.edu/map.html> (last visited November 6, 2020).

<sup>13</sup> See Notice 20-16.

<sup>14</sup> See *supra* note 10.

<sup>15</sup> See Submitted Comments to Securities Exchange Act Release No. 89188 (June 30, 2020), 85 FR 40713 (July 7, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-019), <https://www.sec.gov/comments/sr-finra-2020-019/srfinra2020019.htm>.

<sup>16</sup> See SLB 17. See also Notice 11-54 and Notice to Members 98-38 (May 1998) ("Notice 98-38").

<sup>17</sup> See Notice 20-16. See generally FINRA White Paper, "Technology Based Innovations for Regulatory Compliance ("RegTech") in the Securities Industry" (September 2018) (reporting, among other things, that as financial services firms seek to keep pace with regulatory compliance requirements, they are turning to new and innovative regulatory tools to assist them in meeting their obligations in an effective and efficient manner), [https://www.finra.org/sites/default/files/2018\\_RegTech\\_Report.pdf](https://www.finra.org/sites/default/files/2018_RegTech_Report.pdf).

<sup>18</sup> See *supra* note 5.

<sup>19</sup> See generally Rule 3110(c)(1) and Rule 3110.13 (General Presumption of Three-Year Limit for Periodic Inspection Schedules).

<sup>20</sup> See *supra* note 4.

Rule 3110(c)(1) may satisfy such obligation by conducting the applicable inspection remotely, without an on-site visit to the office or location subject to the other requirements set forth under the proposed supplementary material. In addition, the proposed supplementary material would expressly provide that in accordance with Rule 3110.16, inspections for calendar year 2020 must be completed on or before March 31, 2021 and inspections for calendar year 2021 must be completed on or before December 31, 2021. FINRA believes that providing firms with the option to satisfy the inspection component of Rule 3110(c) remotely would enable firms to finish their 2020 inspections on or before March 31, 2021, and their upcoming 2021 inspections on or before December 31, 2021, particularly given the uncertainty surrounding planning inspections at this time. Further, proposed Rule 3110.17(a) would affirm that notwithstanding Rule 3110.17, a member would remain subject to the other requirements of Rule 3110(c).<sup>21</sup>

#### B. Written Supervisory Procedures for Remote Inspections (Proposed Rule 3110.17(b))

FINRA has long emphasized that member firms have a fundamental obligation to implement a supervisory system that is tailored specifically to the member firm's business and addresses the activities of all its associated persons.<sup>22</sup> As part of an effective supervisory system, a member must establish and maintain written procedures.<sup>23</sup> Paragraph (1) (General Requirements) under Rule 3110(b) (Written Procedures) provides that a member must establish, maintain, and enforce written procedures to supervise

<sup>21</sup> In addition to requiring firms to conduct inspections of their offices and locations on a designated frequency, Rule 3110(c) generally requires a member to retain a written record of the date upon which each review and inspection occurred, reduce a location's inspection to a written report and keep each inspection report on file either for a minimum of three years or, if the location's inspection schedule is longer than three years, until the next inspection report has been written. If applicable to the location being inspected, the inspection report must include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures, in specified areas. See Rule 3110(c)(2). In addition, to prevent compromising the effectiveness of inspections due to conflicts of interest, the rule requires a member to ensure that the person conducting the inspection is not an associated person assigned to the location or is not directly or indirectly supervised by, or otherwise reporting to, an associated person assigned to that location. See Rule 3110(c)(3).

<sup>22</sup> See *Notice to Members* 99-45 (June 1999) ("Notice 99-45"); see generally *Regulatory Notice* 18-15 (April 2018).

<sup>23</sup> See Rule 3110(a)(1).

the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

To underscore the importance of this existing requirement in the context of remote inspections, proposed Rule 3110.17(b) would expressly provide that consistent with a member's obligation under Rule 3110(b)(1), a member that elects to conduct each of its calendar year 2020 or calendar year 2021 inspections remotely must amend or supplement its written supervisory procedures to provide for remote inspections that are reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with applicable FINRA rules. Under proposed Rule 3110.17(b), reasonably designed procedures for conducting remote inspection of offices or locations should include, among other things, a description of the methodology, including technologies permitted by the member, that may be used to conduct remote inspections. In addition, such procedures should include the use of other risk-based systems employed generally by the member firm to identify and prioritize for review those areas that pose the greatest risk of potential violations of applicable securities laws and regulations, and of applicable FINRA rules.<sup>24</sup>

#### C. An Effective Supervisory System (Proposed Rule 3110.17(c))

Internal inspections are a critical component of a member's fundamental obligation under Rule 3110 to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.<sup>25</sup> Proposed Rule 3110.17(c) would expressly affirm this principle that the requirement to conduct inspections of offices and locations is one part of the member's overall ongoing obligation to have an

<sup>24</sup> Offices or locations that may present a higher risk profile would include, for example, those that have associated persons engaging in activities that involve handling customer funds or securities, maintaining books and records as described under applicable federal securities laws and FINRA rules, order execution or other activities that may be more susceptible to higher risks of operational or sales practice wrongdoing, or have associated persons assigned to an office or location who may be subject to additional or heightened supervisory procedures.

<sup>25</sup> See SLB 17 (stating, in part, "Inspections are a vital component of a supervisory system.")

effective supervisory system and therefore, a member must continue with its reviews of the activities and functions occurring at all offices and locations whether or not such offices or locations are due for an inspection under Rule 3110(c) in a given year, and the member's election to conduct such inspections remotely. In addition, under the proposed supplementary material, a member's remote inspection of an office or location, like the traditional on-site inspection, would be held to the same standards for review as set forth under Rule 3110.12 (Standards for Reasonable Review).<sup>26</sup> Further, in accordance with this obligation, proposed Rule 3110.17(c) would provide that where a member's remote inspection of an office or location identifies any indicators of irregularities or misconduct (*i.e.*, "red flags"),<sup>27</sup> the member may need to impose additional supervisory

<sup>26</sup> Rule 3110.12 provides: "In fulfilling its obligations under Rule 3110(c), each member must conduct a review, at least annually, of the businesses in which it engages. The review must be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations and with FINRA rules. Each member shall establish and maintain supervisory procedures that must take into consideration, among other things, the firm's size, organizational structure, scope of business activities, number and location of the firm's offices, the nature and complexity of the products and services offered by the firm, the volume of business done, the number of associated persons assigned to a location, the disciplinary history of registered representatives or associated persons, and any indicators of irregularities or misconduct (*i.e.*, "red flags"), etc. The procedures established and reviews conducted must provide that the quality of supervision at remote locations is sufficient to ensure compliance with applicable securities laws and regulations and with FINRA rules. A member must be especially diligent in establishing procedures and conducting reasonable reviews with respect to a non-branch location where a registered representative engages in securities activities. Based on the factors outlined above, members may need to impose reasonably designed supervisory procedures for certain locations or may need to provide for more frequent reviews of certain locations."

<sup>27</sup> Red flags that suggest the increased risk or occurrence of violations may include, among other events: Customer complaints; an unexplained increase or change in the types of investments or trading concentration that a representative is recommending or trading; an unexpected improvement in a representative's production, lifestyle, or wealth; questionable or frequent transfers of cash or securities between customer or third party accounts, or to or from the representative; a representative that serves as a power of attorney, trustee or in a similar capacity for a customer or has discretionary control over a customer's account(s); representative with disciplinary records; customer investments in one or a few securities or class of securities that is inconsistent with firm policies related to such investments; churning; trading that is inconsistent with customer objectives; numerous trade corrections, extensions, liquidations; or significant switching activity of mutual funds or variable products held for short time periods. See generally SLB 17. See also *Notice* 98-38 and *Notice* 99-45.

procedures for that office or location, or may need to provide for more frequent monitoring or oversight of that office or location, or both, including potentially a subsequent physical, on-site visit on an announced or unannounced basis when the member's operational difficulties associated with COVID-19 meetings abate, nationally or locally as relevant, and the challenges the member is facing in light of the public health and safety concerns make such physical, on-site visits feasible, using reasonable best efforts.

Finally, to underscore the limited duration of proposed Rule 3110.17, the proposed supplementary material expressly states that the temporary relief would not extend to a member's inspection requirements beyond calendar year 2021 and that such inspections must be conducted in compliance with Rule 3110(c).

#### D. Documentation Requirement (Proposed Rule 3110.17(d))

In general, Rule 3110(c)(2) describes the documentation requirements associated with conducting internal inspections. The rule requires a member to reduce the inspection and review conducted under Rule 3110(c)(1) to a written report and specifies how long the member must keep the report on file.<sup>28</sup> If applicable to the location being inspected, Rule 3110(c)(2)(A) specifies that the inspection report must include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures for: (1) Safeguarding of customer funds and securities; (2) maintaining books and records; (3) supervision of supervisory personnel; (4) transmittals of funds from customers to third party accounts, from customer accounts to outside entities, from customer accounts to locations other than a customer's primary residence, and between customers and registered representatives, including the hand-delivery of checks; and (5) changes of customer account information, including address and investment objectives changes, and validation of such changes.<sup>29</sup>

In addition to the requirements under Rule 3110(c)(2), proposed Rule 3110.17(d) would require supplemental documentation by a member that avails itself of the remote inspection option. The member must maintain and preserve a centralized record for each of calendar year 2020 and calendar year 2021 that separately identifies: (1) All offices or locations that had inspections

that were conducted remotely; and (2) any offices or locations that the member determined to impose additional supervisory procedures or more frequent monitoring, as provided in Rule 3110.17(c). A member's documentation of the results of a remote inspection for an office or location must identify any additional supervisory procedures or more frequent monitoring for that office or location that were imposed as a result of the remote inspection. FINRA believes that this documentation requirement would help readily distinguish the offices and locations that underwent remote inspections and their attendant supervisory procedures, and their more frequent monitoring, as applicable.

FINRA notes that even in the current environment, member firms have an ongoing obligation to establish and maintain a system to supervise the activities of their associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. FINRA emphasizes that proposed Rule 3110.17 is not intended to lessen the core obligations prescribed under Rule 3110. FINRA believes that proposed Rule 3110.17, which would permit firms to remotely inspect, subject to specified requirements described above, their offices and locations for calendar years 2020 and 2021 instead of an on-site visit to the office or location would provide firms a way to comply with Rule 3110(c) that would not materially diminish, and is reasonably designed to achieve, the investor protection objectives of the inspection requirements under these unique circumstances. FINRA notes that potential risks that may arise from providing firms the option to conduct their inspections remotely are mitigated by firms' use of technology to meet their supervisory obligations on an ongoing basis, the unique circumstances under which they are operating, and the temporary nature of proposed Rule 3110.17, which would be in place through December 31, 2021.<sup>30</sup> FINRA will continue to monitor the situation and engage with member firms, other financial regulators, and governmental authorities to determine whether further regulatory relief or guidance related to Rule 3110(c) may be appropriate. In addition, during the time that proposed Rule 3110.17 remains in effect, FINRA will closely monitor the effectiveness of remote inspections and their impacts—positive or negative—on firms' overall supervisory systems to assess whether FINRA should propose to make

permanent a remote inspection option for some or all locations that would not materially diminish, and is reasonably designed to achieve, the investor protection objectives of the requirement to inspect offices or locations in accordance with Rule 3110(c).<sup>31</sup>

FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, so FINRA can implement the proposed rule change immediately.

#### 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>32</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. In recognition of the impact of COVID-19 on performing the on-site inspection component of Rule 3110(c), the proposed rule change is intended to provide firms a temporary regulatory option to conduct inspections of offices and locations remotely for calendar year 2020 in accordance with Rule 3110.16, and for calendar year 2021. This temporary proposed supplementary material does not relieve firms from meeting the core regulatory obligation to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules that directly serve investor protection. In a time when faced with unique challenges resulting from the COVID-19 pandemic, FINRA believes that the proposed rule change provides sensibly tailored relief that will afford firms the ability to observe the recommendations of public health officials to provide for the health and safety of their personnel, while continuing to serve and promote the protection of investors and the public interest.

<sup>31</sup> In *Regulatory Notice* 17-38 (November 2017) (“*Notice 17-38*”), FINRA had requested comment on a proposed permanent amendment to Rule 3110 that had contemplated providing firms with the option to conduct remote inspections of “qualifying offices” that met specified criteria. At this time, FINRA intends to defer further consideration of the proposal described in *Notice 17-38* and will reassess that proposal in light of the experience with and impacts of temporary proposed Rule 3110.17.

<sup>32</sup> 15 U.S.C. 78o-3(b)(6).

<sup>28</sup> See *supra* note 21.

<sup>29</sup> See Rule 3110(c)(2)(A)(i)-(v).

<sup>30</sup> See *supra* note 5.

### *B. Self-Regulatory Organization's Statement on Burden on Competition*

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change is intended solely to provide temporary relief given the impacts of the COVID-19 pandemic crisis.<sup>33</sup> As a result of the temporary nature of the proposed relief, an abbreviated economic impact assessment is appropriate.

#### Economic Impact Assessment

##### 1. Regulatory Objective

FINRA is proposing Rule 3110.17 to address an issue that has arisen due to the impacts of the coronavirus outbreak and restrictions related to health and safety concerns. As pandemic-related health and safety concerns persist across the U.S., firms are continuing to face operational challenges with respect to fulfilling the on-site review component of Rule 3110(c). These challenges persist even with the extended date set forth under Rule 3110.16 to complete calendar year 2020 inspections. In addition, as the end of year 2020 is approaching, planning efforts for the on-site component of year 2021 inspections have also likely been impacted.

Proposed Rule 3110.17 is intended to provide firms a sensibly tailored and temporary regulatory accommodation to fulfill their Rule 3110(c) obligation remotely for calendar year 2020 in accordance with Rule 3110.16 and for calendar year 2021, that would not materially diminish, and is reasonably designed to achieve, the investor protection objectives of the requirement to inspect offices or locations in accordance with Rule 3110(c). Such accommodation is needed given the current pandemic-related limitations that still remain in place across the U.S. The temporary proposed rule change would permit firms to continue to comply with stay-at-home orders imposed in various states, and limit business travel and other in-person activities for the health and safety of their employees.

##### 2. Economic Baseline

The Economic Baseline of the proposed temporary relief is the obligation under Rule 3110(c), as described above, and the current number and types of FINRA member locations that require on-site internal inspections.

##### 3. Economic Impact

FINRA initially believes that economic impacts of the proposal would result in both benefits and costs to firms that would not materially diminish, and is reasonably designed to achieve, the investor protection objectives of the requirement to inspect offices or locations in accordance with Rule 3110(c). FINRA will undertake an evaluation of the efficacy of remote inspections within a reasonable period following the implementation date. The aim of such an evaluation is to ensure that the program is meeting its goals, without materially diminishing investor protections or unintentionally increasing regulatory burdens on any relevant parties.

The temporary proposed relief is expected to benefit firms by potentially reducing the costs and health-related risks and constraints associated with conducting on-site inspections of offices or locations. These benefits may also include reduced travel costs and lost productivity during travel, as well as avoiding the health and safety risks associated with on-site inspections in the current environment. Firms will be able to better manage any backlog of 2020 inspections that may continue to exist in light of ongoing public health and safety, and upcoming 2021 inspection planning efforts.

In addition to the public safety-related aspects of the temporary proposed rule change, the ability to conduct remote inspections may free up firm resources that could potentially be allocated to other risk monitoring and mitigating programs. For example, firms might improve existing technologies and capabilities or invest in new ones. This could provide long-term benefits by further enhancing a firm's ability to fulfill its ongoing obligation to have an effective supervisory system that includes reviewing the activities and functions occurring at all offices and locations. The proposed rule change may also provide the opportunity for a firm to enhance its risk management programs, and assess the effectiveness of remote inspections and impacts on the firm's supervisory systems. Finally, FINRA preliminarily believes that the temporary proposed rule change would benefit the investor community. Such benefits would stem from the application of a remote monitoring and supervisory system on the firm's activities taking place at the offices and locations, despite the travel restrictions and resulting inability to conduct on-site inspections during the pandemic.

FINRA believes that the temporary proposed rule change would not result

in additional significant cost burdens on firms. FINRA recognizes that there may be some firms that have already incurred, or will incur short-term increased costs derived mainly from having to shift to the remote work environment (e.g., relying more on electronic formats and purchasing new hardware and software). FINRA anticipates firms would incur some costs stemming from the proposed documentation requirements. FINRA believes that costs stemming from the need to aggregate branch and office reports of additional supervisory procedures or more frequent monitoring into a centralized record should be minimal, relying on existing firm infrastructure and compliance systems. FINRA additionally believes that the proposed requirement to maintain a centralized record may require firms to incur technology costs to generate such record and could also result in firms being more focused on any additional supervisory procedures or more frequent monitoring that may be imposed on a location or office.

Overall, FINRA believes that the proposal provides a balanced approach to the potential costs and benefits. As noted above, the proposed rule change would be limited in time, and cover the inspection cycles of calendar year 2020 and 2021, or until the conclusion of any extension thereof.

### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

Written comments were neither solicited nor received.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Because the foregoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>34</sup> and Rule 19b-4(f)(6) thereunder.<sup>35</sup>

A proposed rule change filed under Rule 19b-4(f)(6) normally does not

<sup>34</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>35</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. FINRA has satisfied this requirement.

<sup>33</sup> See also *Regulatory Notice 20-08* (March 2020).

become operative for 30 days after the date of filing. However, pursuant to Rule 19b-4(f)(6)(iii), the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. In its filing with the Commission, FINRA has asked the Commission to waive the 30-day operative delay so that the proposed rule change may become operative immediately upon filing. As noted above, the ongoing extenuating circumstances of the COVID-19 pandemic make it impractical for FINRA member firms to conduct the on-site inspection component of Rule 3110(c) at many or most locations. Consequently, FINRA believes that firms will have a considerable backlog of 2020 inspections and that planning on-site inspections for 2021 may be impacted as well. FINRA stated that the temporary proposed rule change would help FINRA member firms meet their obligations under Rule 3110(c) using a regulatory alternative that would not materially diminish, and is reasonably designed to achieve, the investor protection objectives of the inspection requirements under these unique circumstances.

The Commission believes that waiving the operative delay is consistent with the protection of investors and the public interest because it would allow the proposed change to become operative on the date of filing and to provide immediate temporary relief to firms during these extenuating circumstances. In reaching this conclusion, the Commission notes the proposed rule change would provide only temporary relief based on the compelling health and safety concerns and the operational challenges member firms are facing due to the sustained COVID-19 pandemic.<sup>36</sup> Furthermore, the Commission notes that the proposed rule change would not relieve firms from meeting the core regulatory obligation to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules that directly serve investor protection. Accordingly, the Commission waives the 30-day operative delay and designates the proposed rule change operative upon filing.<sup>37</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### *Electronic Comments*

- Use the Commission's internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2020-040 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.
- All submissions should refer to File Number SR-FINRA-2020-040. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal

identifying information from comment submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-FINRA-2020-040 and should be submitted on or before December 15, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>38</sup>

**J. Matthew DeLesDernier,**

*Assistant Secretary.*

[FR Doc. 2020-25902 Filed 11-23-20; 8:45 am]

**BILLING CODE 8011-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[SEC File No. 270-177, OMB Control No. 3235-0177]

### Proposed Collection; Comment Request

Extension:

Rule 6e-2 and Form N-6EI-1

Notice is hereby given that, pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Securities and Exchange Commission (the "Commission") is soliciting comments on the collection of information summarized below. The Commission plans to submit this existing collection of information to the Office of Management and Budget for extension and approval.

Rule 6e-2 (17 CFR 270.6e-2) under the Investment Company Act of 1940 ("Act") (15 U.S.C. 80a) is an exemptive rule that provides separate accounts formed by life insurance companies to fund certain variable life insurance products, exemptions from certain provisions of the Act, subject to conditions set forth in the rule.

Rule 6e-2 provides a separate account with an exemption from the registration provisions of section 8(a) of the Act if the account files with the Commission Form N-6EI-1, a notification of claim of exemption.

The rule also exempts a separate account from a number of other sections of the Act, provided that the separate account makes certain disclosure in its registration statements (in the case of those separate accounts that elect to register), reports to contractholders, proxy solicitations, and submissions to state regulatory authorities, as prescribed by the rule.

Since 2008, there have been no filings of Form N-6EI-1 by separate accounts. Therefore, there has been no cost or

<sup>36</sup> See *supra* note 5.

<sup>37</sup> For purposes only of waiving the operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>38</sup> 17 CFR 200.30-3(a)(12).