

How Broker-Dealers Can Prepare For New Remote Work Rules

By **Russell Sacks, Steven Blau and P. Sean Kelly** (February 28, 2024, 4:48 PM EST)

This summer, securities brokers and dealers will have the U.S. Securities and Exchange Commission and Financial Industry Regulatory Authority's approval to work from home and conduct office inspections remotely.

The agencies' recent remote work rules — adopted by the SEC in November, with effective dates announced by FINRA on Jan. 23, 2024 — codify flexible working arrangements adopted by the broker-dealer industry during the COVID-19 pandemic as temporary health measures. But while the rules bring the industry up-to-date in the post-COVID work world, they also impose many conditions and requirements.



Russell Sacks

Overview of the New Rules

Broker-dealers must supervise and control all locations from which their business is done.

FINRA is the self-regulatory organization for the securities broker-dealer industry in the U.S. Among other things, it is tasked by the SEC with the examination and supervision of broker-dealer members of FINRA.[1]



Steven Blau

One of FINRA's central rules is its supervisory control rule,[2] which requires each broker-dealer that is a member of FINRA to categorize every location from which the broker-dealer's business is conducted in one of three categories:

- A branch office;
- An office supervisory jurisdiction, or OSJ, which is an office from which certain specified supervisory activities occur; or
- A nonbranch location.[3]



P. Sean Kelly

Appropriate supervision and control are required to be maintained over all locations, with the supervisory obligations varying in part based on the category of the location. For example, branch offices and OSJs are expected to be inspected at least annually. For nonbranch locations, inspections are required no less frequently than once every three years.

Under the current rules, a personal residence from which broker-dealer-associated persons work on a

regular basis can be deemed to be a nonbranch location provided that various requirements are met.[4] This residential office exception, however, does not apply to an office that would otherwise be categorized as an OSJ due to supervisory activities taking place there.

FINRA's proposed permanent remote work relief has now been approved.

During the COVID-19 pandemic, FINRA issued special relief that facilitated broker-dealer activities taking place from a residential location, including with respect to office categorization. The 2020 regulatory relief also allowed broker-dealers to conduct remote inspections of residential offices during the pandemic.[5]

In 2022, FINRA proposed to modify its supervisory control rules to permit both (1) remote office inspections by member broker-dealers,[6] and (2) the establishment of a new category — a residential supervisory location, or RSL — which would permit certain supervisory activities to occur from a residential office without that office being deemed to be an OSJ.[7] RSLs are instead treated as nonbranch locations for purposes of the supervisory control rules.

On Nov. 17, 2023, the SEC adopted these FINRA proposals.[8]

What does it mean that FINRA rules now permit remote work?

Following the effective date of the new rules, FINRA members will be able to categorize locations from which the business of their broker-dealers is conducted in one of four categories: (1) branch office, (2) OSJ, (3) RSL and (4) nonbranch location. Broker-dealers will also be able to conduct remote office inspections.

The new rules are subject to a host of conditions and exclusions, and both the designation of a location as an RSL and the remote inspection of offices must be subject to written supervisory procedures that are reasonably designed to achieve compliance with the applicable conditions.

What is the timeline for the new rules to take effect?

In January 2024, FINRA issued Regulatory Notice 24-02 announcing the adoption of these proposals, and noting the following effective dates.

Event	Effective Date
Adoption of RSLs	June 1, 2024
Adoption of Remote Inspections	July 1, 2024
End of 2020 Regulatory Relief	May 31, 2024 (for residential locations)
End of 2020 Regulatory Relief	June 30, 2024 (for remote inspections)

The remainder of this article describes the new rules and offers some commentary on them.

Residential Supervisory Locations

What is, and what is not, a residential supervisory location?

As noted above, an RSL is a new broker-dealer office location category, supplementing the existing three

categories found in FINRA Rule 3110: nonbranch locations, branch offices and OSJs.

An RSL is a location that is the associated person's private residence, where certain specified supervisory activities are conducted.[9] An RSL will be considered for those activities to be a nonbranch location, provided that the other restrictions and limitations described below are met.

Notably absent from the definition of "RSL" are the activities described by Rule 3110(f)(2)(A) through (C): "(A) order execution or market making; (B) structuring of public offerings or private placements; (C) maintaining custody of customers' funds or securities." These exclusions materially affect the ability of broker-dealers to allow remote work for trading and investment banking personnel.

The RSL proposing release notes — and confirms — the absence of these activities, and concludes as follows: "Longer term, FINRA expects to reassess the OSJ and branch office definitions under Rule 3110(f) more generally as part of its continued efforts to modernize FINRA rules." Firms that will permit personnel to conduct such excluded activities from residential locations must now treat such locations as OSJs.

What are the conditions for residential supervisory location designation?

In order to designate a residential location as an RSL, the location must meet a host of conditions. In general, the associated person must reside at the location, the location cannot be held out to the public as an office of the broker-dealer, and the associated person using the residential location cannot meet with customers at the RSL.

Sales activity that takes place at the location must comply with specified conditions,[10] and the broker-dealer must determine that its surveillance and technology tools are appropriate to supervise the business of the broker-dealer that is taking place at the RSL, including with respect to the retention of communications, tools relating to the specific business conducted and cybersecurity systems.

What criteria make a broker-dealer firm ineligible for RSL designation?

In order for a FINRA member to designate associated persons' locations as RSLs, that broker-dealer must not be subject to one of the enumerated ineligibility criteria. A broker-dealer will be ineligible to designate an office or location as an RSL if the firm:

- Is subject to a firmwide restriction under FINRA rules;[11]
- Is or becomes suspended by FINRA;
- First became a member of FINRA within the prior 12 months; or
- Has been found by the SEC or FINRA to have failed to properly conduct a review of its own business within the past three years.[12]

What else would make a location ineligible?

In addition, an office or location will not be eligible for designation as an RSL if certain location eligibility criteria are not met.

One of the key location ineligibility criteria is that a location cannot be designated as an RSL if one or

more associated persons at the location is a designated supervisor with less than one year of direct supervisory experience with the firm. A person subject to heightened supervision cannot work from an RSL, nor can any person who has had certain disciplinary events disclosed on his or her Form U4 in the prior three years.[13]

Remote Inspections

What is the pilot program?

During the COVID-19 pandemic, firms discovered that conducting remote inspections of residential office locations is an important component of permitting remote work.

New FINRA Rule 3110.18 establishes a voluntary, three-year remote inspections pilot program to allow eligible FINRA-member firms to fulfill the inspection obligations of their locations, including branch offices, OSJs, nonbranch locations and now RSLs remotely, without an on-site visit to such offices or locations.

A firm must affirmatively elect to participate in the pilot program by providing FINRA with an opt-in notice, and once enrolled, must affirmatively elect to withdraw from the pilot program by providing FINRA with an opt-out notice, in the form and manner prescribed by FINRA.[14]

In Regulatory Notice 24-02, FINRA states that it is currently developing a technological process in FINRA Gateway through which firms will be able to provide FINRA with the requisite notices electronically. FINRA states that it will provide further details about the manner and format of these notices in subsequent guidance.

What is the risk assessment requirement, and what factors must be considered?

Prior to electing a remote inspection for an office or location, rather than an on-site inspection, the FINRA-member firm must develop a risk-based approach to using remote inspections, and conduct and document a risk assessment for that office or location.

The assessment must document the factors considered, including the factors set forth in Rule 3110.12,[15] and must take into account any higher-risk activities that take place at, or higher-risk associated persons that are assigned to, that office or location.

A member or its office or location that is ineligible for remote inspections because of the criteria noted below must conduct an on-site inspection of that office or location.

What are the written supervisory procedures and documentation requirements?

Under the new rule, a member that elects to participate in the pilot program must establish and maintain written supervisory procedures regarding remote inspections that are reasonably designed to achieve compliance with applicable securities laws and regulations.

In the rule, FINRA states that reasonably designed procedures for conducting remote inspections of offices or locations must memorialize a host of specific factors and criteria, including the methodology and technology used to conduct remote inspections, as well as the specific procedures applicable to remote inspection.

Firms that opt into the pilot program must retain specified books and records regarding remote inspections.

What are the firm-level and location-level ineligibility criteria?

As with the designation of RSLs, broker-dealer firms are not eligible to conduct remote inspections of any offices or locations if, at any time during the pilot program, the firm becomes subject to specified ineligibility criteria that are substantially similar to the firm-level ineligibility criteria for RSLs. Similarly, an office or location is not eligible for a remote inspection if, at any time during the pilot program, one or more of the associated persons at the applicable office or location becomes subject to specified ineligibility criteria that are substantially similar to the location-level ineligibility criteria for RSLs.

A location is also ineligible if, among other things, one or more associated persons at the location are engaged in proprietary trading, or if the location handles customer funds or securities.

What is the data collection requirement?

Any firm that participates in the pilot program must collect a wide swath of data and provide that data to FINRA on a quarterly basis. This data includes information regarding, for example, the number of locations that were inspected remotely, the number of locations that were inspected on-site and the number of locations inspected where findings were identified.

Conclusion

The expansion of broker-dealers' ability to permit flexible working arrangements through the introduction of the RSL category and through the conduct of remote inspections is a welcome one. Not only are flexible working arrangements now the norm in the financial industry, but the ability to offer more flexible working arrangements better allows broker-dealers to attract and retain talent, especially talent from groups that are historically underrepresented in the industry.

Furthermore, various non-broker-dealer financial industry participants that compete with broker-dealers for talent can offer flexible working arrangements, and the absence of the RSL category would put broker-dealers at a disadvantage in seeking to hire and retain talent — again, especially talent from underrepresented groups.

Broker-dealers must now turn their attention to compliance with the many, many conditions and requirements in order to take advantage of these new rules, including the various procedures and assessments that are required prior to designating an RSL or conducting remote inspections.

Russell D. Sacks is a partner, Steven R. Blau is counsel and P. Sean Kelly is a senior associate at King & Spalding LLP.

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[1] Virtually all SEC-registered broker-dealers are members of FINRA and subject to FINRA rules. In 2023,

the SEC narrowed its rule allowing certain broker-dealers to operate outside of FINRA membership. See SEC Release 34-98202, "Exemption for Certain Exchange Members" (August 20, 2023).

[2] See FINRA Rule 3110 (Supervision).

[3] See FINRA Rule 3110(a)(3) and (f).

[4] See FINRA Rule 3110(f)(2)(ii).

[5] See FINRA Regulatory Notice 20-08, "Pandemic-Related Business Continuity Planning, Guidance and Regulatory Relief" (March 9, 2020). See also Rule 3110.17 ("Temporary Relief to Allow Remote Inspections for Calendar Years 2020, 2021, 2022, 2023, and Through the Earlier of the Effective Date of the Remote Inspections Pilot Program, if Approved, or June 30, 2024."), (Together, the "2020 Regulatory Relief").

[6] See SEC Release 34-96520, "Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Partial Amendment No. 1 to Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision)" (December 16, 2022), withdrawn and replaced by SR-FINRA-2023-06.

[7] See SEC Release 34-96191, "Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) (October 31, 2022), withdrawn and replaced by SR-FINRA-2023-07. These proposals were withdrawn and refiled in 2023: See SEC Release 34-97398, "Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision)" (April 28, 2023) ("Remote Inspections Proposing Release"). See also, SEC Release 34-96191, "Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision)" (March 31, 2023) ("RSL Proposing Release").

[8] See SEC Release 34-98982 "Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change to Adopt Supplementary Material .18 (Remote Inspections Pilot Program) under FINRA Rule 3110 (Supervision)", (November 17, 2023) ("Remote Inspection Adopting Release"), and see also SEC Release 34-98980, "Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, to Adopt Supplementary Material .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision)", November 17, 2023 ("Residential Supervisory Location Adopting Release"). The Remote Inspection Adopting Release was published in the Federal Register on November 24, 2023: see 88 Fed. Reg. 82464 (November 24, 2023). The Residential Supervisory Location Adopting Release was published in the Federal Register on that same day: see 88 Fed. Reg. 82447 (November 24, 2023).

[9] The activities specifically enumerated as supervisory activities for purposes of the RSL designation are: "(D) final acceptance (approval) of new accounts on behalf of the member; (E) review and endorsement of customer orders; (F) final approval of retail communications for use by persons associated with the member, pursuant to Rule 2210(b)(1), except for an office that solely conducts final approval of research reports; or (G) responsibility for supervising the activities of persons associated

with the member at one or more other branch offices of the member." Also enumerated is the activity described at Rule 3110(f)(2)(B): "any location that is responsible for supervising the activities of persons associated with the member at one or more nonbranch locations of the member [...]."

[10] The specified conditions are those found at Rule 3110(f)(2)(A)(ii) and (iii), and are largely redundant to the RSL location restrictions. The nonredundant requirements are: "(ii) [...] g. All orders are entered through the designated branch office or an electronic system established by the member that is reviewable at the branch office; h. Written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member; and i. A list of the residence locations is maintained by the member; and, (iii) Any location, other than a primary residence, that is used for securities business for less than 30 business days in any one calendar year."

[11] For example, a broker-dealer firm will be ineligible to designate any office as an RSL if such firm is a Restricted Firm under FINRA Rule 4111, a firm required to tape customer-facing telephone calls under Rule 3170, or receives a notice regarding capital compliance failures under Rule 4110.

[12] Rule 3110(c) is the portion of FINRA Rule 3110 that requires each FINRA member broker-dealer to conduct an annual assessment of its compliance function. The member ineligibility criteria establish an important new collateral consequence for firms to consider when negotiating enforcement matters with FINRA.

[13] Form U4 is the Uniform Application for Securities Industry Registration or Transfer for individuals. The relevant questions cited are: "14A(1) Have you ever: (a) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign, or military court to any felony? (2)(a) Based upon activities that occurred while you exercised control over it, has an organization ever: been convicted of or pled guilty or nolo contendere ("no contest") in a domestic or foreign court to any felony? 14B(1) Have you ever: (a) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign or military court to a misdemeanor involving: investments or an investment-related business or any fraud, false statements or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses? (2)(a) Based upon activities that occurred while you exercised control over it, has an organization ever: been convicted of or pled guilty or nolo contendere ("no contest") in a domestic or foreign court to a misdemeanor specified in 14B(1)(a)?" Question 14C outlines a broad array of findings made by the SEC or CFTC. Question 14D outlines a broad array of findings made by any other Federal regulatory agency or any state regulatory agency or foreign financial regulatory authority. 14E outlines a broad array of findings made by FINRA or other self-regulatory organizations.

[14] For Pilot Program Year 1, which starts on July 1, 2024, and ends on December 31, 2024, the timeframe in which an eligible firm may elect to opt in to the Pilot Program is June 1, 2024, through June 26, 2024. An eligible firm that does not elect to join Pilot Year 1 by June 26, 2024 may choose to join the Pilot Program for a subsequent Pilot Year on or before these December 27, 2024 (to join Pilot Year 2), December 27, 2025 (to join Pilot Year 3), and December 27, 2026 (to join Pilot Year 4, which lasts from January 1, 2027, to June 30, 2027). In general, a firm must withdraw from the Pilot Program by December 27 of any year in order to withdraw in the subsequent year.

[15] FINRA Rule 3110.12 sets standards for reasonable review of a firm's businesses. The factors cross-referenced in the Remote Inspections rule are: "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." In addition to the factors set out in Rule 3110.12, the Remote Inspections rule requires a firm to consider the following factors: (A) the volume and nature of customer complaints; (B) the volume and nature of outside business activities, particularly investment-related; (C) the volume and complexity of products offered; (D) the nature of the customer base, including vulnerable adult investors; (E) whether associated persons are subject to heightened supervision; (F) failures by associated persons to comply with the member's written supervisory procedures; and (G) any recordkeeping violations. In addition, FINRA notes that firms should conduct on-site inspections or make more frequent use of unannounced, on-site inspections for high-risk offices or locations or where there are indicators of irregularities or misconduct (i.e., "red flags").