

Legal Update

FINRA CEO Comments Suggest Reconsideration of On-Site Exams in Light of COVID-19

In statements made at SIFMA's Virtual Compliance and Legal Forum, FINRA Chief Executive Officer, Robert Cook, indicated that FINRA may be reconsidering aspects of its cycle examinations in light of the challenges presented by the COVID-19 pandemic. FINRA conducts between 1,500 and 2,000 risk-based cycle examinations annually to assess identified risks and controls and determine whether firms are in compliance with federal securities laws, rules and regulations. These examinations typically have an on-site component to them, where FINRA staff arrive at a firm's office to continue their assessment of the firm's business.

As we are all aware, the limitations on in-person contact due to COVID-19 have led to a significant uptick in remote and telework arrangements, which have permeated throughout nearly all aspects of the broker-dealer business. Because of those limitations, the on-site component of FINRA examinations was halted early in 2020. Cook's comments indicate that, although examinations will still have to find a way to move forward, FINRA may be flexible in finding a mutually agreeable solution. Cook reportedly stated that FINRA will take a "risk-based approach" and would "decide on a case-by-case basis" whether examinations need to be in person.

To FINRA's credit, it has granted (and further extended) some temporary relief to its members with respect to their regulatory obligations in light of COVID-19.¹ Many, however, are concerned that these temporary measures will not be enough.

For example, FINRA Rule 3110(c) generally requires that firms conduct internal inspections of their business on a regular basis. Although FINRA has long interpreted Rule 3110(c) to include an on-site inspection component, there is no legal or rules-based requirement mandating on-site inspections.² Based on the current state of affairs and temporary relief, firms are required to complete their calendar year 2020 inspection obligations by March 31, 2021.³

Given the environment, many firms have expressed justifiable concern with meeting regulatory obligations that may not be feasible given their current operational limitations and impending deadlines. A number of industry members have been clamoring for further relief from the on-site inspection requirement and presented alternatives and more permanent solutions to regulators, such as remote inspections.⁴

With respect to the impending deadline for 2020 inspections, Cook noted that FINRA may allow firms to extend the deadline further into 2021,

although he questioned how far they could continue to delay, “If we keep extending the deadline, it is just gonna be a snowplow effect where there’s more and more of a backlog for people to work through.” Cook also noted that FINRA was working on a proposal with the SEC to allow firms to conduct remote inspections, if only for 2020 and 2021.

Given more experience with remote inspections, many are hopeful that FINRA will determine that remote supervision can become an adequate mechanism to conduct on-site examinations and inspections on a going-forward basis.

If you or your firm have questions about compliance with your regulatory obligations during COVID-19 or related relief provided by FINRA or the SEC, or if you would like us to advocate for guidance or relief on your behalf, please contact the authors or any member of our Broker-Dealer Regulation & Compliance practice. We have been closely monitoring new developments and will continue to provide updates relating to COVID-19 and related FINRA and SEC relief.

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Endnotes

¹ See <https://www.finra.org/rules-guidance/key-topics/covid-19/temporary-amendments-to-finra-rules>.

² FINRA, Remote Branch Office Inspections, Regulatory Notice 17-38 (Nov. 13, 2017), <https://www.finra.org/rules-guidance/notices/17-38>.

³ FINRA, Proposed Rule Change to Temporarily Extend the Time to Complete Office Inspections under FINRA Rule 3110 (Supervision), SR-FINRA-2020-019 (June 19, 2020).

⁴ See, e.g., <https://www.sifma.org/wp-content/uploads/2020/08/SIFMA-Comment-Letter-SR-FINRA-2020-019-as-filed-with-the-SEC-on-7-28-2020-final.pdf>.

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