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How FINRA Should Adapt its Rules to the Work-From-Home Reality.

Potential changes to Financial Industry Regulatory Authority rules would likely reflect on the municipal space as the regulator contemplates lessons learned during the pandemic and dealers seek greater work-from-home flexibility.

In comment letters filed Tuesday, dealer groups said FINRA should work with the Securities and Exchange Commission and Municipal Securities Rulemaking Board to make potential rule changes more cohesive. Though FINRA doesn't write rules for municipal securities, changes to its rules would likely reflect on MSRB rules.

"A lot of the points we make in the context of remote work, work at home and other lessons learned from the pandemic apply equally to the municipal bond business as they do to corporate bonds," said Michael Decker, senior vice president of policy and research at Bond Dealers of America.

Remote work has been so successful, BDA wrote in its letter to FINRA, that some firms are considering implementing work-from-home on a permanent basis. Some of BDA's member firms reported that as office leases come up for renewal, they have considered shrinking the size of offices or eliminating them.

"It is our understanding that other regulators like the Securities and Exchange Commission and the Municipal Securities Rulemaking Board are also examining their regulations that apply to remote work and other issues brought about by the pandemic," BDA wrote. "It is important that FINRA and the other agencies collaborate closely and conduct parallel rulemaking as appropriate."

The regulatory process could take some time. Changes to MSRB rules could be a part of the MSRB's ongoing retrospective rule review, Decker said. Earlier this month, the MSRB decided to retire decades-old guidance as part of that review.

Issues tend to arise when MSRB and FINRA rules don't match, Decker said, leading to dealers incorrectly applying rules.

BDA asked for changes to FINRA's Rule 3110 on supervision, which is similar to the MSRB Rule G-27 on supervision. BDA wants FINRA to amend its rule so that employees conducting trading, sales, or banking activity from home are not mandated to have annual inspections of employees' homes.

Branch offices are inspected every three years and offices of supervisory jurisdiction (OSJ) — where order execution, endorsing customer orders, among others takes place — annually.

"From the rule, it appears that a trader working at home with authority to make trade execution decisions is an OSJ," BDA said. "However, we do not believe it is FINRA's intention to require inspections of employees' homes even if they are working from home."

BDA's letter also asked FINRA to consider a risk-based approach when deciding whether in-person

examinations are necessary.

The Securities Industry and Financial Markets Association said an almost fully remote work environment has brought a “quantum leap” towards adopting fully remote capabilities, work habits, procedures, and controls.

SIFMA wants FINRA to revise its definitions of OSJ and branch offices in its Rule 3110. The pandemic has demonstrated that almost all tasks can be done by employees working remotely without on-site supervision, so those terms should be updated, SIFMA said. Using its current rule, firms would have to register a number of one-person branches at remote locations and private homes, SIFMA added, and in the meantime, FINRA should issue additional guidance.

The MSRB would likely amend its Rule G-27 if FINRA made such changes, said Leslie Norwood, SIFMA’s managing director, associate general counsel, and head of municipals.

SIFMA also wants changes to FINRA rules so that a location would not be registered as an OSJ or a branch office if there is no customer-facing activity or handling of customers’ funds or securities, so long as there is a reasonably-designed system of supervision in place.

If a location can’t meet certain requirements such as having few customer complaints or complying with federal securities laws and FINRA rules on books and record keeping, and also meets the definition of a branch office or OSJ, then that location should be registered, SIFMA said. FINRA should also allow dealers to work from home without being subjected to on-site examinations as long as they have adequate supervision, SIFMA said.

“The COVID-19 pandemic has proven that it is possible to shift operations to decentralized, remote locations on short notice,” SIFMA said.

“However, we recognize the broad range of broker-dealers which FINRA supervises, some of which may neither have the capabilities to conduct activities in a fully electronic manner, nor the financial resources to upgrade to such a paradigm.”

Therefore the “new paradigm should be presented as a complementary framework,” SIFMA added.

FINRA allows its member firms to do remote inspections through 2021, and FINRA should allow firms to continue that indefinitely, SIFMA said. FINRA should also take a risk-based approach when it comes to supervision. FINRA Rule 3110 is largely based on where certain activities are conducted, said Kevin Zambrowicz, SIFMA managing director & associate general counsel.

“If certain activities, such as supervising another office, occur at a location then a range of regulatory requirements are triggered,” Zambrowicz said. “SIFMA believes that changes in technology and firm-client interactions should result in changes to FINRA Rule 3110 so that firms focus more on the level of risk than where an activity is conducted.”

Bond Dealers of America

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by Sarah Wynn

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