

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52402; File No. SR-NYSE-2002-34)

September 9, 2005

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2 and 3 to the Proposed Rule Change Relating to the Amendment of Rule 342 (Offices-Approval, Supervision and Control) to Provide for a Uniform Definition of “Branch Office”

I. Introduction

On August 16, 2002, the New York Stock Exchange, Inc. (“NYSE” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend NYSE Rule 342 (“Offices-Approval, Supervision and Control”) to provide for a new definition of the term “branch office.” On October 22, 2002, the NYSE submitted Amendment No. 1 to the proposed rule change.³ The proposed rule change, as amended by Amendment No. 1, was published for comment in the Federal Register on December 4, 2002.⁴ The Commission received five comment letters with respect to the proposal, as amended.⁵ In addition, the Commission received seven comment letters with respect to a

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy Sanow, Assistant Director, Division of Market Regulation (“Division”), Commission, dated October 21, 2002 (“Amendment No. 1”).

⁴ See Securities Exchange Act Release No. 46888 (November 22, 2002), 67 FR 72257 (“Notice”).

⁵ See letters to Jonathan G. Katz, Secretary, Commission from Arthur F. Grant, President, Cadaret Grant, dated December 17, 2002 (“Cadaret Letter”) and Brian C. Underwood, Senior Vice President - Director of Compliance, A.G. Edwards & Sons, Inc., dated December 18, 2002 (“A.G. Edwards Letter 1”) and December 27, 2002 (“A.G. Edwards Letter 2”); letter to Secretary, Commission from Kimberly H. Chamberlain, Vice President and Counsel, State Government Affairs, Securities Industry Association, dated December 23, 2002 (“SIA Letter 1”); and email to Katherine A. England, Assistant

similar filing by the National Association of Securities Dealers, Inc. (“NASD”)⁶ that specifically addressed the NYSE’s proposed rule change.⁷ On March 31, 2003, the Exchange filed a response to the comment letters,⁸ and on April 20, 2004, and August 25, 2005, the Exchange filed Amendment Nos. 2⁹ and 3¹⁰ to the proposed rule change, respectively. This order approves the proposed rule change, as amended by Amendment No. 1; grants accelerated approval to

Director, Division, Commission from Jeffrey P. Halperin, Assistant Vice President, Corporate Ethics and Compliance, Metropolitan Life Insurance Company, dated January 7, 2003 (“MetLife Letter 1”).

⁶ See Securities Exchange Act Release No. 48897 (December 9, 2003), 68 FR 70059 (December 16, 2003) (SR-NASD-2003-104).

⁷ See letters to Commission from Thomas Moriarty, President, InterSecurities, Inc., dated January 6, 2004 (“InterSecurities Letter”), Christopher Shaw, Vice President & Acting Chief Compliance Officer, Transamerica Financial Advisors, Inc., dated January 6, 2004 (“TFA Letter”); letters to Jonathan G. Katz, Secretary, Commission from Leonard M. Bakal, Vice President and Compliance Director, Metropolitan Life Insurance Company, dated January 14, 2004 (“MetLife Letter 2”), Mario DiTrapani, President, Association of Registration Management, dated January 6, 2004 (“ARM Letter”); John Polanin, Jr., Chairman, Self-Regulation and Supervisory Practices Committee, Securities Industry Association, dated January 9, 2004 (“SIA Letter 2”); and letters to Secretary, Commission from John Gilner, Vice President, Henry H. Hopkins, Vice President, and Sarah McCafferty, Vice President, T. Rowe Price Investment Services, Inc., dated January 5, 2004 (“Investment Services Letter”), and Minoos Spellerberg, Compliance Director, Prncor Financial Services Corporation, dated February 6, 2004 (“Prncor Letter”).

⁸ See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy Sanow, Assistant Director, Division, Commission, dated March 27, 2003 (“Response to Comments”).

⁹ See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy Sanow, Assistant Director, Division, Commission, dated April 19, 2004 (“Amendment No. 2”). In Amendment No. 2, the Exchange responded to comments and amended proposed NYSE Rule 342.10 by eliminating the 50-day limitation from its primary residence registration exception and adding a provision relating to supervisory procedures of primary residences and risk-based sampling criteria. See also discussion of Amendment No. 2 in Section II, Description of the Proposal, *infra*.

¹⁰ See Form 19b-4 dated August 25, 2005 (“Amendment No. 3”). In Amendment No. 3, the Exchange amended proposed NYSE Rule 342.10 and its discussion to clarify certain points made in Amendment No. 2, issues related to the timing of the adoption of the Exchange’s new definition of branch office, and other issues related to the Exchange’s definition of branch office as compared with the NASD’s rule proposal. See also discussion of Amendment No. 3 in Section II, Description of the Proposal, *infra*.

Amendment Nos. 2 and 3 to the proposed rule change; and solicits comments from interested persons on Amendment Nos. 2 and 3.

II. Description of the Proposal

Current NYSE Rule 342(c) requires that a member or member organization obtain the Exchange's prior written consent for each office established other than a main office. Office is generally defined as any location – other than a main office- from which the business of the member or member organization is conducted. Locations such as primary residences, operations offices/centers, temporary locations, and offices of convenience are all required to be registered as branch offices.¹¹ Continued advances in technology used by firms to conduct, monitor, and surveil the activities at their branch offices and other remote locations, as well as changes in the structure of broker-dealers and in the lifestyles and work habits of the work force, have caused the Exchange to reexamine whether all business locations continue to need to be registered as branch offices of members and member organizations.

There is currently no uniform standard that regulators use in defining this term. These disparate definitions impose unintended burdens on common members and member organizations in the form of compliance with multiple and different definitions of branch office, the filing of multiple forms to register and/or renew registration of such locations, different filing deadlines for such registrations, and continued monitoring of the rules of multiple self-regulatory organizations (“SROs”) and states for changes.¹²

¹¹ See Amendment No. 2, supra note 9.

¹² Id.

The Exchange has participated in a joint regulatory initiative with the NASD and state securities regulators to develop a uniform definition of “branch office” in an attempt to eliminate unnecessary burdens on members. The Exchange, the NASD and the North American Securities Administrators Association (“NASAA”) have worked together to propose a uniform definition of branch office.¹³ Accordingly, the Exchange proposes to amend NYSE Rule 342 to provide for a new definition of the term “branch office.” The proposed amendment to the rule would limit the requirement to register certain business locations as branch offices to account for advances in technology used to conduct and monitor business, changes in the structure of broker-dealers and in the lifestyles and work habits of associated persons of broker-dealers.

As proposed, the term “branch office” would mean any location¹⁴ where one or more associated persons of a member or member organization regularly conducts the business of effecting any transactions in, or inducing or attempting to induce, the purchase or sale of any security, or where such location is held out as a branch office.¹⁵ The definition would provide for exceptions as noted below. The proposed definition would substantially mirror the Commission’s definition of “office” in its Books and Records rules (SEC Rules 17a-3 and 17a-4) under the Act.¹⁶ As noted above, the NASD has also filed with the Commission a proposed new branch office definition, which is substantially similar to the Exchange’s proposal.¹⁷

¹³ Id.

¹⁴ Amendment No. 3 deleted the exclusion “other than the main office” from the definition of branch office as initially proposed. See Amendment No. 3, supra note 10.

¹⁵ For purposes of this rule, the term “associated person of a member or member organization” would be defined in proposed NYSE Rule 342.10 as a member, allied member, or employee associated with a member or member organization. Id.

¹⁶ 17 CFR 240.17a-3 and 17a-4.

¹⁷ See SR-NASD-2003-104, supra note 6. The Commission is simultaneously approving the NASD’s proposed rule change. See Securities Exchange Act Release No. 52403 (September 9, 2005).

Attempting to recognize current business, lifestyle, and surveillance practices, the Exchange provides flexibility in the form of seven exceptions from the proposed branch office registration requirement.¹⁸ As discussed in the Notice,¹⁹ in developing a definition, the NYSE considered the evolving nature of its members' and member organizations' business models and proposed exceptions to the registration requirement accordingly. For instance, any office of convenience, where an associated person occasionally and exclusively by appointment meets with customers and which is not held out to the public as a branch office, would be exempt from registering as a branch office.²⁰ Other than meeting customers at these offices of convenience, all other functions of the associated person would be conducted and supervised through the designated branch office.

The Exchange also proposes to exempt primary residences from the definition of branch office. In exempting primary residences, the Exchange imposes limitations on such locations to ensure that all activity is appropriately supervised and monitored by the firm. The limitations provide that: only one associated person, or multiple associated persons, who reside at that

¹⁸ See proposed NYSE Rule 342.10 (A) through (G) and Amendment No. 2, supra note 9.

¹⁹ See Notice, supra note 4.

²⁰ For example, bank-owned members and member organizations often establish small offices on bank premises, whereby a registered representative would be designated to a parent branch for supervision, but would visit different bank branches occasionally, and by appointment only, to meet with customers. Under the proposed definition, such locations would be exempt from registering as branch offices, where the bank location is not held out as a branch office. In exempting such offices of convenience from branch office registration, the NYSE imposed important safeguards for the public. In this regard, at such offices of convenience, associated persons would be limited to meeting customers occasionally and exclusively by appointment. Furthermore, at bank locations, the only permitted signage such offices of convenience could display, under regulations promulgated by the Office of the Comptroller of the Currency, would be ones advertising to the public that “non-deposit investment products” are being offered at such locations in order to prevent confusing customers who might otherwise believe that traditional riskless investments, such as deposits, are being offered by associated persons at such offices located on bank premises. Id.

location and are members of the same immediate family, conduct business at the location; the location not be held out as a branch office; the associated person be assigned to a designated branch office for supervision, and such office be reflected on all business cards, stationery, advertisements, and communications to the public; the associated person not meet with customers at his or her residence; neither customer funds nor securities be handled at that location; the associated person's correspondence and communications with the public be subject to all supervisory provisions of the Exchange's rules including, but not limited to, NYSE Rules 342 and 472;²¹ electronic communications, including e-mails, be made through the firm's electronic system; all orders be entered through the designated branch office or an electronic system established by the member or member organization that is reviewable at the branch office;²² written supervisory procedures relating to the supervision of sales activities conducted at the residence be maintained by the member or member organization; and a list of the locations be maintained by the member or member organization.²³

The definition would also exempt from branch office registration any temporary location, other than the primary residence discussed above, that is used for securities business²⁴ for less than 30 business days in any calendar year. In granting this exemption, the NYSE imposes most of the same safeguards noted above for the exemption granted for a primary residence.²⁵

²¹ See Amendment No. 3, supra note 10.

²² Id.

²³ The NYSE had originally proposed a limitation that the associated person's primary residence be used for less than 50 business days in one calendar year. However, as discussed further, the Exchange eliminated the 50-day limitation from the proposed primary residence exception in response to comments. See Amendment No. 2, supra note 9.

²⁴ See Amendment No. 3, supra note 10.

²⁵ The NYSE proposes to define "business day" to exclude any partial day, provided the associated person spends at least four hours on such business day at his or her designated

In addition, the definition would exempt from registration locations where associated persons are primarily engaged in non-securities activities (e.g., insurance) and from which an associated person effects no more than 25 securities transactions in a calendar year, provided that advertisements or sales literature identifying such location also set forth the location from which the associated persons would be directly supervised. Further, such activities attendant to the primary function and performed as an occasional accommodation to customers would be conducted through and supervised by the associated person's designated registered branch office.

Similarly, the new definition would exempt non-sales locations, e.g., where operations activities are conducted, from registering as a branch office. Such locations would have to be established solely for customer service and/or back office functions, not be held out to the public as a branch office, and no sales activities would be conducted from such locations.²⁶

However, as discussed further in Amendment No. 3 below, the Exchange also proposes that, notwithstanding the exclusions in NYSE Rule 342.10 (A) – (G), any location that is responsible for supervising the activities of persons associated with a member or member organization at one or more non-branch locations of such member or member organization would be considered to be a branch office.²⁷ The Exchange is proposing this change in order to conform with a comparable provision in the NASD's rule proposal.²⁸

branch office during the hours such office is normally open for business. See NYSE Rule 342.10 explanatory material.

²⁶ The definition would also exempt the Floor of a registered national securities exchange where a member or member organization conducts a direct access business with public customers and a temporary location established in response to the implementation of a business continuity plan. See proposed NYSE Rule 342.10 (F) and (G).

²⁷ See proposed NYSE 342.10 explanatory material and Amendment No. 3, supra note 10.

²⁸ See SR-NASD-2003-104, supra note 6.

Amendment No. 2

The difference between the NYSE's definition of branch office as initially proposed and the NASD's definition concerns the registration of certain primary residences as branch offices. The NASD proposes a functionality test to determine whether primary residences should register as a branch office, considering limitations on the activities that could be performed.²⁹ In addressing the use of primary residences, important safeguards and limitations were imposed by both SROs on such locations to provide for the monitoring and oversight of activities. As originally proposed, the NYSE's primary residence registration exception incorporated the same limitations as the NASD, but also limited to 50, the number of business days associated persons would be permitted to engage in securities activities in their primary residences without requiring such residences to register as a branch office.

However, as discussed in more detail below, after analysis of the comments received from and related discussions with members and member organizations, the Exchange now proposes to eliminate the 50-day limitation from its primary residence registration exception. In eliminating the 50-day limitation on primary residences, the Exchange acknowledges that technological advances in surveillance/monitoring capabilities should help address the concerns noted above while accommodating evolving lifestyles and work habits of the industry. At the same time, the Exchange wishes to impose appropriate regulatory/supervisory safeguards to help ensure that members and member organizations properly supervise such locations.

As proposed in Amendment No. 2 and slightly amended in Amendment No. 3, Exchange members' and member organizations' written supervisory procedures would have to include criteria for on-site for cause reviews of an associated person's primary residence. Such reviews

²⁹Id.

would have to utilize risk-based sampling or other techniques designed to assure compliance with applicable securities laws and regulations and with NYSE rules.³⁰ Factors which should be considered when developing risk-based sampling techniques to determine the appropriateness of on-site for cause reviews of selected residences and other remote locations would have to include, at a minimum: (1) the firm's size; (2) the firm's organizational structure; (3) the scope of business activities; (4) the number and location of offices; (5) the number of associated persons assigned to a location; (6) the nature and complexity of products and services offered; (7) the volume of business done; (8) whether the location has a Series 9/10-qualified person on-site; (9) the disciplinary history of the registered person or associated person, including a review of such person's customer complaints and Forms U4 and U5; and (10) the nature and extent of a registered person's or associated person's outside business activities, whether or not related to the securities business.³¹

Additional criteria should be utilized if applicable to the nature and type of business conducted by the member or member organization and the individual registered person(s) involved. Such supervisory procedures would, in the aggregate, be required to be sufficient to ensure compliance with the securities laws and Exchange rules.

Given that such locations are physically remote from registered branch offices, members and member organizations, in establishing supervisory procedures, would have to be particularly proactive and preemptive in their approach to supervision. As a matter of reasonable supervision, firms should, before granting permission to work at these remote locations, review

³⁰ See also Amendment No. 3, supra note 10. Similarly, written supervisory procedures for such residences and other remote locations would have to be designed to assure compliance with applicable securities laws and regulations and with NYSE rules. See Amendment No. 2, supra note 9.

³¹ See also Amendment No. 3, supra note 10.

all applicable criteria to determine whether such person should be permitted to work at such location and whether he/she requires heightened supervision.

The Exchange believes that initial review/approval, ongoing monitoring, and follow-up with respect to outside business activities by registered persons, whether or not related to the securities business, is particularly important, especially when such activities are conducted from such person's residence. The Exchange believes that, given the nature of these locations, registered persons could utilize their outside business activities to conceal violations of Commission and SRO rules. Accordingly, in developing risk-based criteria to determine the extent and frequency of on-site reviews, members and member organizations should give particular weight to this factor.

The Exchange believes that the regulatory approach adopted by the Exchange for these locations is consistent with the approach that the Commission recently articulated in its Staff Legal Bulletin No. 17: Remote Office Supervision, regarding the supervision of small, remote offices.³² Supervisory procedures, which do not address the minimum requirements noted above, would be deemed inadequate for purposes of NYSE Rule 342, and could subject members and member organizations to disciplinary action for failure to supervise.³³ The Exchange will be reviewing such procedures and their implementation as part of its regular examination of members and member organizations.

Amendment No. 3

In Amendment No. 3, the Exchange proposed additional changes to its rule text and

³² See Division, SEC, Staff Legal Bulletin No. 17, dated March 19, 2004.

³³ Whereas the federal securities laws, Section 15(b)(4)(E) of the Act, 15 U.S.C. 78o(b)(4)(E), provide for sanctions on a firm and its supervisors for failing to supervise a person who is subject to their supervision and commits a violation of the federal securities laws, the SRO supervision rules do not require a predicate violation to impose sanctions for failing to supervise. See Amendment No. 3, supra note 10.

discussion to clarify certain points made in Amendment No. 2, other issues related to the Exchange's definition of branch office as compared with the NASD's rule proposal, and issues related to the adoption of the Exchange's new branch office definition.

The Exchange proposes the following changes to NYSE Rule 342:

- i. In NYSE Rule 342.10, the phrases "other than the main office," and "(("associated person"))" have been deleted from the definition of branch office. In deleting the qualifier "other than the main office," the Exchange is recognizing instances where a member organization's activities taking place in the main office (e.g., where one or more associated persons of a member or member organization regularly conduct the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of any security, or is held out as a branch office), would place the main office in the purview of the definition, and thus it should be registered as a branch office. Further, branch office registration would be triggered where associated persons are domiciled in the main office of a member or member organization and are engaging in the above activities. Accordingly, the Exchange recognizes that whether an office is a branch office is a function of the activities performed at the office even if such activities are performed at the main office. In addition, the latter deletion is being made by the NYSE to maintain a uniform definition of branch office.
- ii. The text of Rule 342.10(B)(v) has been changed from "the associated person's correspondence and communications with the public are subject to the firm's supervision" to "the associated person's correspondence and communications with the public are subject to all supervisory provisions of the Exchange's rules including, but not limited to, Rules 342 and 472." This change was made to

eliminate any possible ambiguity that might have suggested that associated persons working from home were subject to supervisory standards different from those of other associated persons subject to the supervision of a member or member organization.

- iii. The text of Rule 342.10(B)(vi) has been changed from “electronic communications (i.e., e-mail) are made through the member organization’s electronic system” to “electronic communications (e.g., e-mail) are made through the member’s or member organization’s electronic system.” This change was made to indicate that e-mail is only an example of electronic communications covered by the rule and to make it consistent with other sections in the rule.
- iv. The following changes have been made to conform to the NASD’s rule proposal. NYSE Rule 342.10(B)(vii) has been changed to include orders entered in an electronic system established by the member or member organization that is reviewable at the branch office. NYSE Rule 342.10(C) has been changed by adding “securities business for” to clarify that primary residences excluded from the definition of branch office may be used, on a limited basis, for securities business.
- v. In NYSE Rule 342.10 explanatory material, the phrase “[t]he term ‘business day’ as used herein” has been changed to “[f] or purposes of this Rule, the term ‘business day’” to make its wording consistent with the wording used in other definitions in this section.
- vi. In NYSE Rule 342.10 explanatory material, the sentence “[t]he term an ‘associated person of a member’ for purposes of this Rule means member, allied member or employee associated with a member or member organization” has

been changed to “[f]or purposes of this Rule, the term ‘associated person of a member or member organization’ is defined as a member, allied member, or employee associated with a member or member organization” to make its wording consistent with the wording used in other definitions in this section.

- vii. A new paragraph is being added to the Rule 342.10 explanatory material. As proposed, it provides that “notwithstanding the exclusions in subparagraphs 342.10(A) – (G), any location that is responsible for supervising the activities of persons associated with a member or member organization at one or more non-branch locations of such member or member organization is considered to be a branch office.” The Exchange thus recognizes instances where such locations could be discharging supervisory activities that warrant their registration as branch offices with the attendant regulatory responsibility and oversight. This amendment is being proposed to conform with a comparable provision in the NASD’s rule proposal.
- viii. In NYSE Rule 342.10 explanatory material, the term “sufficient” has been deleted from the sentence “[f]or purposes of Rule 342.10(B)(viii) and (C), written supervisory procedures for such residences and other remote locations must be designed to assure compliance with applicable securities laws and regulations and with NYSE Rules,” to make it more consistent with the prior sentence, “[f]or purposes of Rule 342.10(B)(viii), written supervisory procedures shall include criteria for on-site for cause reviews of an associated person’s primary residence. Such reviews must utilize risk-based sampling or other techniques designed to assure compliance with applicable securities laws and regulations and with NYSE rules.”

- ix. The Supplementary Material section of NYSE Rule 342 titled “Annual fee,” which is currently numbered 342.10, will instead be numbered 342.11 due to a numbering conflict with other sections of NYSE Rule 342.
- x. Current NYSE Rule 342.11 (“Registered representative operating from residence”) has been deleted because other proposed amendments to NYSE Rule 342 make it redundant.

Furthermore, to clarify its response to comments made in Amendment No. 2, the Exchange reiterates its belief that its proposal would actually result in reduced overall industry costs by virtue of the fact that the exclusion of certain primary residences and several other types of locations currently required to register would cause a decline in the overall number of branches. In support of this statement, the Exchange, after reviewing its database of branch offices, estimates that the proposed definition would reduce the number of branch offices from approximately 16,000 to approximately 12,800, a reduction of approximately 20 percent.

In addition, the Exchange clarifies a footnote in Amendment No. 2 to more accurately express the Exchange’s intended point that whereas the federal securities laws provide for sanctions on a firm and its supervisors for failing to supervise a person who is subject to their supervision and commits a violation of the federal securities laws, the SRO’s supervision rules do not require a predicate violation to impose sanctions for failing to supervise.

In order to make use of a technique mandatory without requiring any particular technique that might not be appropriate for every member organization, the Exchange also amended the explanatory material in NYSE Rule 342.10 relating to written supervisory procedures of an associated person’s primary residence, to clarify that the criteria for on-site for cause reviews of an associated person’s primary residence would have to utilize risk-based sampling or other techniques designed to assure compliance with applicable securities laws and regulations and

with NYSE rules. Furthermore, the Exchange notes that it has added factors (e.g., the firm's size, the firm's organizational structure, the number and location of offices, and the number of associated persons assigned to a location) to be considered when member firms develop risk-based sampling techniques to determine the appropriateness of on-site for cause review of residences and other remote locations. The Exchange believes that these additional factors will better enable member firms to make such determinations.

Finally, the Exchange emphasizes that a registered representative in a branch office classified as a "small office" pursuant to Interpretations /01 and /02 of NYSE Rule 342.15 may not be the supervisor of that or any other office or non-branch location unless he or she is Series 9/10 qualified, regardless of that person's designation as the registered representative "in charge" of the office.

In proposing a uniform definition with exclusions, the Exchange recognizes that, in an evolving business and regulatory environment, it cannot capture every conceivable business arrangement/structure its members or member organizations seek to utilize. Accordingly, the Exchange will review, on a case-by-case basis, instances where a firm's proposal does not fall squarely within the rule and/or its exclusions.

With respect to the timing of the adoption of the Exchange's proposed definition of branch office, the Exchange states that the proposed new definition of branch office is "the product of a coordinated effort among regulators to reduce inconsistencies in the definitions used by the Commission, NASD, the NYSE, and state securities regulators in identifying locations where broker/dealers conduct securities or investment banking business."³⁴ The proposed new definition is intended "to facilitate the creation of a branch office registration system through the

³⁴ See Amendment No. 3, supra note 10 (referencing SR-NASD-2003-104).

Central Registration Depository (“CRD”) to provide a more efficient, centralized method” for members and member organizations “to register branch office locations as required by the rules and regulations of states and self-regulatory organizations.”³⁵ It is expected that both the Exchange and the NASD will revise their forms to incorporate the respective new definitions of branch office, and that the new forms will become operational on CRD during the fourth quarter of 2005.³⁶

The Exchange believes that implementing its new definition of branch office prior to revising the CRD and the related forms will make the transition to the new branch office registration system and forms smoother, since its members’ and member organizations’ familiarity with the new definition will allow them to concentrate on the subsequent technical changes in the branch registration process. The Exchange does not believe that changing its definition of branch office prior to the aforementioned CRD changes will create confusion or in any way undermine the coordinated transition to the new branch office registration system.

III. Summary of Comments and NYSE’s Response

As noted above, the Commission received five comment letters with respect to the Notice,³⁷ and seven comment letters with respect to a similar filing by the NASD³⁸ that specifically addressed the NYSE’s proposed rule change.³⁹ The NYSE filed a response letter to address concerns raised by the commenters.⁴⁰

³⁵ Id.

³⁶ See Securities Exchange Act Release No. 51923 (June 24, 2005), 70 FR 38229 (July 1, 2005) (SR-NYSE-2005-13).

³⁷ See supra note 5.

³⁸ See supra note 6.

³⁹ See supra note 7.

⁴⁰ See Response to Comments, supra note 8.

Comment Letters

The commenters generally applauded the NYSE, the NASD, and NASAA for their efforts in creating a uniform definition of branch office, reducing the regulatory burdens currently imposed upon firms, and accounting for advances in technology and changes in the structure of broker-dealer firms and in the lifestyle and work habits of associated persons of broker-dealers.⁴¹ One commenter noted that this attempt at uniformity would only be successful if all exchanges, regulatory agencies, and states adopt consistent definitions and uniformly interpret those definitions.⁴²

However, the commenters believed that the proposed amendments to the definition of branch office would substantially increase the number of offices that must be inspected and that NYSE member firms would have to annually inspect every office, including homes, vacation homes or convenience offices, meeting the definition of a “branch office.”⁴³ Similarly, another commenter believed that imposition of the new definition of branch office would result in firms needlessly having to closely monitor where work was being performed and for how long, and that the logistical difficulties created by the NYSE proposal would encourage some firms to prohibit people from working outside the office.⁴⁴ Furthermore, the likelihood that firms would choose not to track but rather to register everybody or preclude activity outside the branch office would be increased by the serious consequences for an inadvertent failure to register.⁴⁵

⁴¹ See A.G. Edwards Letter 2, ARM Letter, InterSecurities Letter, MetLife Letter 1, MetLife Letter 2, Princor Letter, SIA Letter 1, SIA Letter 2, TFA Letter, supra notes 5 and 7.

⁴² See A.G. Edwards Letter 2, supra note 5.

⁴³ See A.G. Edwards Letter 1, A.G. Edwards Letter 2, SIA Letter 1, supra note 5.

⁴⁴ See SIA Letter 1, supra note 5.

⁴⁵ Id.

A few commenters also believed that, if the proposed NYSE definition is adopted, the number of registered branch offices would increase dramatically and result in substantial increased costs for large and small firms.⁴⁶ One commenter observed that the substantial costs associated with this proposed definition would not be limited to branch office supervision, but that additional costs would include costs associated with tracking employees' activity to determine whether or not they fall within the 50 or 30 day exclusions and a substantial increase in registration costs and fees.⁴⁷ Accordingly, it would be possible that the registration, bonding, personnel, and supervisory costs associated with this proposed definition would outweigh any cost savings through central registration.⁴⁸

Furthermore, the commenters generally believed that the proposal presents a huge burden for firms with far-reaching branch networks and were generally against the 50-day cap on working from home and the 30-day cap on working at other locations in order to qualify under the primary residence exception.⁴⁹ They believed that there would be no customer protection or regulatory interest served by requiring annual inspections of a location merely based on the number of days someone works from a location, if the location is not "held out" to the public, if no customer funds or securities are maintained at the location, and if the location is not used to conduct functions that occur in an office of supervisory jurisdiction.⁵⁰ Specifically, according to

⁴⁶ See SIA Letter 1, MetLife Letter 1, supra note 5.

⁴⁷ See SIA Letter 1; see also MetLife Letter 1, supra note 5.

⁴⁸ See SIA Letter 1, supra note 5.

⁴⁹ See A.G. Edwards Letter 1, A.G. Edwards Letter 2, MetLife Letter 1, SIA Letter 1, supra note 5; see also ARM Letter, InterSecurities Letter, Investment Services Letter, MetLife Letter 2, Prncor Letter, SIA Letter 2, and TFA Letter (supporting the NASD's decision to eliminate the fifty-day limitation for the primary residence exception), supra note 7.

⁵⁰ See A.G. Edwards Letter 1, A.G. Edwards Letter 2, ARM Letter, SIA Letter 1, supra notes 5 and 7.

some commenters, what matters should be the type of activities performed at the site, the records maintained, the number of registered representatives working there, the ability to conduct supervision, and how the location is held out to the public, and not on an arbitrary criteria such as the number of days spent at the location.⁵¹ Similarly, some of the commenters believed that real investor protection comes from limiting the types of activities performed outside the branch office and providing appropriate supervision of all associated persons, regardless of where they are conducting their business. As long as these two criteria are satisfied, the 50-day cap on working from home and the 30-day cap on working at other locations is unnecessary, unduly cumbersome, and of little value.⁵² Another commenter believed that the SROs should not require the registration of a representative's residence under most circumstances. This commenter believed that the primary effect of adding a requirement to register homes and other locations that are not held out to the public would be an increase in fees that firms must pay to their regulators.⁵³

Moreover, one commenter believed that the definition of "office" in the SEC's Books and Records Rule, Rule 17a-3(h)(1),⁵⁴ is not identical to the definition contained in the Exchange's proposal. The commenter believed that, if the SEC definition is not interpreted so that any location that is excluded from the definition of "branch office" in this rule would also be excluded from the SEC definition, there would be significantly higher costs and additional regulatory burdens. Furthermore, an inconsistent interpretation of the definition under the Books

⁵¹ See ARM Letter, SIA Letter 1, SIA Letter 2, supra notes 5 and 7; see also A.G. Edwards Letter 2, supra note 5.

⁵² See A.G. Edwards Letter 2, SIA Letter 1, supra note 5; see also MetLife Letter 2 (against the 50-day requirement in the primary residence exception as being burdensome, time-consuming and difficult to enforce), supra note 7.

⁵³ See MetLife Letter 1, supra note 5.

⁵⁴ 17 CFR 240.17a-3(h)(1).

and Records Rule could lead to a situation where a state could require that records be maintained or produced at a location that is not a “branch office” within the NYSE proposal.⁵⁵ Similarly, another commenter expressed concern that the mere act of registering a primary residence as a branch office could be misinterpreted as satisfying the “holding out” requirement in SEC Rule 17a-4(l) of the Act⁵⁶ and therefore lead to a situation where a state would require that records be maintained or produced at a location that would not otherwise be deemed a “branch office” under SEC rules. This commenter requested that the NYSE and/or the Commission clarify that this would not be the case.⁵⁷

NYSE’s Response to Comments

The Exchange agrees, in part, with some of the comments relating to the proposed branch office definition’s exceptions and has, thus, excepted primary residences and other locations from the definition, if certain appropriate supervisory and business limitations safeguards are satisfied by the member or member organization. In justifying the Exchange’s initial proposal to impose a 50-day limitation for the primary residence exception, the Exchange stated that, notwithstanding the need for flexibility, adequate supervision could be most effectively accomplished when associated persons are assigned to, and have some actual physical presence at, a supervised location. By limiting the number of full business days that associated persons could conduct business at non-branch locations, members and member organizations could better supervise such persons while still providing them the flexibility that their lifestyles require today. The Exchange believed that the proposed 50- and 30-day limitations in the proposed exceptions

⁵⁵ See A.G. Edwards Letter 2, supra note 5.

⁵⁶ 17 CFR 240.17a-4(l).

⁵⁷ See SIA Letter 1, supra note 5.

would provide further flexibility by excluding partial business days at a broker's designated branch office during the hours such office is normally open for business.⁵⁸

However, as noted above, after analysis of and in response to the comments received, the Exchange has eliminated its 50-day limitation on the primary residence registration exception. In eliminating the 50-day limitation on primary residences, the Exchange acknowledges that technological advances in surveillance/monitoring capabilities should help address the concerns posed by associated persons working from home, combined with the rest of the limitations in the exemption. At the same time, the Exchange still proposes to impose appropriate regulatory/supervisory safeguards, such as on-site review of such residences and remote locations, to help ensure that members and member organizations properly supervise such locations.⁵⁹

In response to the comments that the new definition would present logistical obstacles and result in substantial time and effort to track each associated person's whereabouts and to register those locations that satisfy the 30-day threshold, the Exchange notes that the 30-day business day exclusion was proposed to address changes in lifestyle and work habits for

⁵⁸ See Response to Comments, supra note 8. Furthermore, if an associated person, i.e., registered representative ("RR"), works primarily from his or her home, the Exchange believed that such location should be registered as a branch office subject to all attendant requirements including firm supervision and examination. Although an RR could not hold out his or her residence as a branch office, in reality customers would generally come to know that the RR is working from home. As a result, the Exchange believed that it would be likely that RRs would eventually meet with customers at their homes, or that customers would stop by to drop off checks or securities' certificates. In addition, when an RR works primarily from home, he or she would keep records there and might not be diligent in ensuring that all required records are provided to the designated branch office. Id.

⁵⁹ See Amendment No. 2, supra note 9.

associated persons.⁶⁰ The Exchange indicates that flexible work schedules usually are prearranged and are something such persons and their firms should be aware of on a prospective basis. However, the Exchange recognizes that exigent circumstances could arise where such information would not be clearly foreseeable to such persons and their firms. Since the Exchange has no interest in inadvertent rule violations that arise as the result of unforeseen circumstances, the Exchange intends to provide flexibility through interpretative relief for such unforeseen circumstances. Once the thresholds have been met, the Exchange represents that members and member organizations would be given a 30-day window to submit applications for registering such locations as branch offices. Pending branch office approval, associated persons could continue conducting business from such locations. If approved, the location would be a branch office. If not approved, the associated person would have to immediately cease conducting business at the location.⁶¹

The Exchange would also address the industry's concerns regarding the perceived logistical problems associated with the Exchange's proposed definition by providing the same threshold flexibility in the registration/approval process of primary residences for locations that exceed the "25 securities transaction" exclusion permitted under proposed NYSE Rule 342.10(E). Furthermore, the Exchange will provide interpretative guidance as to what constitutes a "securities transaction" for purposes of this exclusion from the definition of branch office. For example, transactions effected pursuant to a dividend reinvestment plan, or similar types of transactions would be excluded in calculating the 25 securities transactions threshold. In aggregate, the Exchange believes that the registration/approval process and exclusions from

⁶⁰ These same concerns were raised with respect to the 50-day threshold; however, the NYSE has eliminated the 50-day threshold in response to the comments received.

⁶¹ See Response to Comments, supra note 8.

the 25 securities transactions threshold should alleviate some of the industry's perceived concerns with regard to the proposed definition.⁶²

Moreover, the Exchange believes that the commenters' concern that registering primary residences and other locations used for securities business would impose substantial costs overlooks current NYSE rules that require all offices, including residential offices, to be registered. In addition, each branch office location is currently required to be inspected on an annual basis. Accordingly, the Exchange believes that adoption of the proposed rule would reduce the number of locations that would be required to be registered by NYSE members and member organizations by eliminating locations such as exempt residences, locations engaged in customer service and back office operations, offices of convenience, and locations used primarily for non-securities activities.⁶³ In support of this statement, the Exchange, after reviewing its database of branch offices, estimates that the proposed definition would reduce the number of

⁶² Id.

⁶³ Id. See also, Amendment No. 2, supra note 9. The proposal would actually result in reduced overall industry costs by virtue of the fact that the exclusion of certain primary residences and several other location types currently required to register would cause a decline in the overall number of branches. Id. Finally, the Exchange disagrees with the commenters' view that the 50-day limitation that was initially proposed raises potential inconsistencies with the SEC's books and records rule. On the contrary, the Exchange believes that its proposed definition is not inconsistent with the SEC's books and records requirement and, in fact, incorporates the substance of SEC Rule 17a-3(h)(1), 17 CFR 240.17a-3(h)(1). The Exchange believes that the act of registering a primary residence as a branch office would not, in and of itself, constitute "holding out" for purposes of the SEC's new record keeping requirements. In dealing with primary residences, the Exchange has imposed many of the conditions required under SEC Rule 17a-4(l), 17 CFR 240.17a-4(l). Where a primary residence exceeds the 50-day threshold and thus would be required to register as a branch office (as initially proposed), it would not necessarily be required to maintain records at that office. Rather records could be maintained at the designated branch office that is responsible for supervision of the home office, provided that the member or member organization adheres to the criteria of the rule. See Response to Comments, supra note 8.

branch offices from approximately 16,000 to approximately 12,800, a reduction of approximately 20 percent.⁶⁴

In summary, the Exchange represents that, in proposing its definition of “branch office,” among other things, it is the Exchange’s intent to reduce regulatory burdens for the industry and to provide for a consistent approach among various securities regulators with respect to branch offices and other business locations.⁶⁵

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 2 and 3, including whether Amendment Nos. 2 and 3 are 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 e-mail to rule-comments@sec.gov. Please include File Number SR-NYSE-2002-34 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NYSE-2002-34. This file number should be included on the subject line if e-mail 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 Web site (<http://www.sec.gov/rules/sro.shtml>). Copies

⁶⁴ See Amendment No. 3, *supra* note 10.

⁶⁵ See Response to Comments, *supra* note 8.

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 inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSE-2002-34 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations promulgated thereunder applicable to a national securities exchange and, in particular, with the requirements of Section 6(b) of the Act.⁶⁶ Specifically, the Commission finds that approval of the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act⁶⁷ in that it is designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; to remove impediments to

⁶⁶ 15 U.S.C. 78f(b). In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

⁶⁷ 15 U.S.C. 78f(b)(5).

and perfect the mechanism of a free and open market and a national market system; and in general, to protect investors and the public interest.

Given the continued advances in technology used to conduct and monitor businesses and changes in the structure of broker-dealers and in the lifestyles and work habits of the workforce, the Commission believes it is reasonable for the Exchange to reexamine whether all business locations need to be registered as branch offices of broker-dealer members and member organizations. The Commission also supports the Exchange, the NASD and state securities regulators' joint, regulatory effort to eliminate inconsistencies and duplication by developing a uniform definition of "branch office." The Commission believes that such regulatory coordination and cooperation will result in an effective and efficient regulation that will serve the entire broker-dealer community by recognizing the many different business models and streamlining the branch office registration process significantly. In addition, the Commission believes that the proposed definition strikes the right balance between providing flexibility to broker-dealer firms to accommodate the needs of their associated persons, while at the same time setting forth parameters that should ensure that all locations, including home offices, are appropriately supervised. In this regard, the Commission emphasizes the responsibility of firms to supervise their associated persons, regardless of their location and reminds all broker-dealers of their statutory duty to supervise.⁶⁸ The Commission also believes that the ability to identify the personnel located at each branch office is an important improvement to the CRD database and will provide regulators valuable information.

Furthermore, the Commission believes that the seven proposed exceptions to registering as a branch office constitute a reasonable approach to recognize current business, lifestyle, and

⁶⁸ See Section 15(b)(4)(E) of the Act, 15 U.S.C. 78o(b)(4)(E).

surveillance practices and provide associated persons with flexibility with respect to where they perform their jobs. For instance, because associated persons may have to work from home due to illness, or to provide childcare or eldercare for certain family members, the Commission believes it is appropriate to except primary residences from the definition of branch office. In this regard, the Commission believes that the Exchange has also directly responded to negative comments on the 50-day cap on working from home and, accordingly, eliminated such limitation from its primary residence exception. This change made the proposed definition substantially similar to the definition proposed by the NASD. Moreover, the definition would also exempt from branch office registration any temporary location, other than the primary residence, provided it is used less than 30 business days in any calendar year.

The Commission finds it reasonable for the Exchange to not only propose conditions on the primary residence and temporary location exceptions (e.g., the location can not be held out to the public as an office, neither customer funds nor securities can be handled there) but to also impose appropriate supervisory safeguards and limitations to help ensure that members and member organizations properly supervise and monitor such locations. For instance, the Exchange proposes to require that written supervisory procedures for such residences and other remote locations include criteria for on-site for cause reviews of an associated person's primary residence and that such reviews utilize risk-based sampling or other techniques designed to assure compliance with securities laws and regulations. The Exchange also included a list of factors which should be considered when developing risk-based sampling techniques for on-site reviews of such locations.⁶⁹ The Commission agrees with the Exchange that effective

⁶⁹ The Commission notes that the factors proposed in NYSE Rule 342, which should be considered when developing risk-based sampling techniques to determine the appropriateness of on-site for cause reviews of primary residences and other remote locations, are substantially similar to the factors proposed by the NASD in SR-NASD-

supervision can be achieved using advanced and sophisticated technology in the supervision and review of associated persons in such exempt locations. In this regard, the Commission expects the Exchange to review such written supervisory procedures and their implementation as part of its regular examination of members and member organizations.

In addition, under both exceptions noted above, the NYSE has provided additional flexibility by defining “business day” to exclude any partial day, provided the associated person spends at least four hours on such business day at his or her designated branch office during the hours such office is normally open for business. The Commission believes that this should prevent associated persons from regularly conducting business from other remote locations for the majority of a business day, without such activity being counted towards the 30-day limitation. The Commission expects the Exchange to monitor and ensure that, where the 30-business day (other location) exemption is utilized by associated persons, members and member organizations are maintaining records adequate to demonstrate compliance with the “business day” limitations.

Finally, the Commission believes it is reasonable for the Exchange to establish and implement its new definition of branch office before the changes to the CRD and the related forms are implemented. This should make the transition to the new branch office registration

2003-104. See SR-NASD-2003-104, supra note 6. However, while the NASD’s list of factors would broadly apply to the internal inspections and review of their members’ businesses, including offices of supervisory jurisdiction (“OSJs”), branch offices, and non-branch offices, the NYSE’s proposed list of factors would apply only to primary residences and other remote locations. However, the Commission notes that the NYSE provides for branch office inspections in NYSE Rule 342/03 of the NYSE Interpretation Handbook (“Handbook”). Under NYSE Rule 342/03 of the Handbook, an annual branch office inspection program must include, but is not limited to, testing and independent verification of internal controls related to the following areas: safeguarding of customer funds and securities; maintaining books and records; supervision of customer accounts serviced by branch office managers; transmittal of funds between customers and

system and forms smoother by providing Exchange members and member organizations with sufficient time to become familiar with the new definition and to focus on the subsequent technical changes in the branch registration process. As the Exchange represents, changing the definition of branch office prior to the aforementioned CRD changes should not create confusion, or in any way undermine the coordinated transition to the new branch office registration system.

Accelerated Approval of Amendment Nos. 2 and 3

The Commission finds good cause for approving Amendment Nos. 2 and 3 to the proposed rule change prior to the thirtieth day after the amendment is published for comment in the Federal Register pursuant to Section 19(b)(2) of the Act.⁷⁰ Amendment No. 2 responded to comment letters by amending proposed NYSE Rule 342 to eliminate the 50-day limitation from its primary residence registration exception, adding a provision requiring written supervisory procedures of primary residences and other remote locations, and listing factors which should be considered in developing risk-based sampling techniques. The Commission finds that, given the objections raised with respect to the 50-day limitation and the potential logistical difficulties that could have resulted in complying with and enforcing the rule, it is appropriate and responsive for the Exchange to eliminate this condition from its proposed exception. Also, elimination of the 50-day limitation renders the NYSE's proposal virtually identical to the NASD's proposal, serving the industry's desire for uniformity. Furthermore, the Commission believes that requiring written supervisory procedures for primary residences and other remote locations and providing a list of factors which should be included in the development of the risk-based

registered representatives and between customers and third parties; validation of customer address changes, and validation of changes in customer account information.

⁷⁰ 15 U.S.C. 78s(b)(2).

sampling techniques in the proposed rule text will clarify members' and member organizations' obligations in monitoring the use of these exceptions, as well as provide for effective supervision and review of associated persons in such exempt locations.

Amendment No. 3 provides a more comprehensive list of factors to be considered in the development of the risk-based sampling techniques, makes technical and clarifying changes to the rule text, and provides a discussion on the timing of the adoption of the Exchange's new definition of branch office. The Commission believes that the proposed changes in Amendment No. 3 provide for a clearer understanding of the implementation of the proposed branch office definition. Specifically, the Commission agrees with the Exchange that branch office registration should be primarily determined by the functions performed in an office. For instance, the Exchange's proposed deletion of the qualifier "other than the main office" from the definition of branch office recognizes that the definition of branch office and its corresponding registration should be triggered based on the activities performed at the location, even if the activities are performed at the main office. Similarly, the Exchange also proposes that, despite the seven exceptions to the definition of branch office, any location responsible for supervising the activities of persons associated with a member or member organization at one or more non-branch locations of such member or member organization should nevertheless register as a branch office. The Commission notes that this rule change is similar to one proposed by the NASD in its branch office filing. Finally, the Commission notes that the additional technical and clarifying changes made to NYSE Rule 342.10 raise no new issues of regulatory concern.

Accordingly, the Commission believes that accelerated approval of Amendment Nos. 2 and 3 is appropriate.

VI. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Section 6(b)(5) of the Act.⁷¹

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁷² that the proposed rule change (SR-NYSE-2002-34) and Amendment No. 1 thereto are approved, and that Amendment Nos. 2 and 3 thereto are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷³

Jonathan G. Katz
Secretary

⁷¹ 15 U.S.C. 78f(b)(5).

⁷² 15 U.S.C. 78s(b)(2).

⁷³ 17 CFR 200.30-3(a)(12).