

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-53789; File No. SR-NYSE-2006-05)

May 11, 2006

Self-Regulatory Organizations; New York Stock Exchange, Inc. (n/k/a New York Stock Exchange LLC); Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to Amendments to the Interpretation of NYSE Rule 345 (Employees – Registration, Approval, Records)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 17, 2006, the New York Stock Exchange, Inc.<sup>3</sup> (n/k/a New York Stock Exchange LLC) (“NYSE” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NYSE. On May 3, 2006, NYSE filed Amendment No. 1 to the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The NYSE is filing with the SEC a proposed amendment to Interpretation (a)/02 (“Independent Contractors”) of NYSE Rule 345 (“Employees – Registration, Approval, Records”). The proposed rule change would reduce the filing requirements in connection with the establishment of an “independent contractor” relationship between a natural person, who is required to be registered pursuant to NYSE Rule 345, and a member organization.

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

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

<sup>3</sup> The Exchange is now known as the New York Stock Exchange LLC. See Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006).

<sup>4</sup> See Amendment No. 1.

The text of the proposed rule change is available on the Exchange's Web site ([www.nyse.com](http://www.nyse.com)), at the principal office of the Exchange, and at the Commission's Public Reference Room.

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

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

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

1. Purpose

(a) Background

Over the years, registered persons and member organizations have on occasion entered into arrangements wherein the registered person is designated an "independent contractor" of the member organization. Such arrangements are often pursued due to tax planning considerations on the part of the individual and/or cost saving considerations on the part of the organization. Specifically, persons asserting independent contractor status may be eligible for certain tax benefits, especially with respect to retirement planning. On the other hand, some member organizations have structured their business model so that certain overhead costs (e.g., office rent, secretarial services, etc.) are borne by the registered representative in the context of an independent contractor arrangement.

NYSE Rule 345(a) requires that natural persons performing certain prescribed duties on behalf of a member organization be registered with and qualified by the Exchange.<sup>5</sup> The Interpretation of NYSE Rule 345(a)<sup>6</sup> permits a registered representative to assert the status of “independent contractor” provided that any registered representative associated with a member organization who is so designated be considered an employee of that member organization for purposes of the rules of the Exchange.

Currently, the Interpretation subjects all such independent contractor arrangements to prior Exchange approval pursuant to the submission of written representations which the Interpretation categorizes into four sections. First, the Interpretation requires a representation from the member organization that it will supervise and control all activities of the independent contractor effected on its behalf to the same degree and extent that it regulates the activities of all other registered representatives and in a manner consistent with NYSE Rule 342. Second, it requires that a copy of the written agreement between the independent contractor and the member organization be submitted to the Exchange and that such agreement provides that the independent contractor will engage in securities-related activities solely on behalf of the member organization (except as otherwise explicitly may be permitted by the member organization in writing); that such securities-related activities will be subject to the direct, detailed supervision, control and discipline of the member organization; and that such person is not subject to a “statutory disqualification” as defined in Section 3(a)(39) of the Act.<sup>7</sup> Third, the Interpretation

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<sup>5</sup> NYSE Rule 345(a) states that “[n]o...member organization shall permit any natural person to perform regularly the duties customarily performed by (i) a registered representative, (ii) a securities lending representative, (iii) a securities trader or (iv) a direct supervisor of (i), (ii) or (iii) above, unless such person shall have been registered with, qualified by and is acceptable to the Exchange.”

<sup>6</sup> See NYSE Interpretation Handbook, Rule 345(a)/02.

<sup>7</sup> See 15 U.S.C. 78a et seq.

requires the prospective independent contractor to submit an undertaking subjecting him or herself to the jurisdiction of the Exchange. And fourth, it requires the member organization to provide to the Exchange assurances that the prospective independent contractor is covered by the organization's fidelity insurance and that compliance has been had with applicable state Blue Sky provisions.

The proposed amendments would eliminate the requirement to submit these representations to the Exchange, as the regulatory purposes they serve (e.g., to provide notice to the Exchange of independent contractor arrangements; to ensure that member organizations are aware of their responsibility to supervise independent contractors; and to ensure that the Exchange is able to assert jurisdiction over such persons in the event of a violation of Exchange and/or Federal securities laws) can now be more efficiently accomplished in light of recent regulatory developments.

Specifically, the Exchange branch office<sup>8</sup> and Form U4<sup>9</sup> applications are now processed through the Central Registration Depository ("CRD") System. Unlike previous versions, the revised version of Form U4 requires registration applicants to disclose if they maintain an independent contractor relationship with the member organization that will be carrying the registration. This disclosure provides notice to the Exchange of all independent contractor relationships between registered persons and member organizations, thereby obviating the need to submit duplicative notice.

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<sup>8</sup> Exchange branch office applications are processed via Form BR. See Securities Exchange Act Release No. 52543 (September 30, 2005); 70 FR 58771 (October 7, 2005) (File No. SR-NYSE-2005-13). See also NYSE Information Memo No. 05-75 dated October 6, 2005.

<sup>9</sup> Uniform Application for Securities Industry Registration or Transfer. Form U4 includes information such as an individual's ten-year employment history, five-year residential

Further, by executing Form U4, the independent contractor signatory agrees to abide by the rules of any self-regulatory organization (“SRO”), including the Exchange, to which their member organization is subject, thereby establishing the jurisdictional reach formerly provided by the above-noted written representation to the Exchange. Specifically, the revised version of Form U4 requires registered persons who seek to become associated with a member organization to “submit to the authority of the jurisdictions and SROs and agree to comply with all provisions, conditions and covenants of the statutes, constitutions, certificates of incorporation, by-laws and rules and regulations of the jurisdictions and SROs as they are or may be adopted, or amended from time to time.”<sup>10</sup>

(b) Proposed Amendments

The Exchange strongly believes that there be no ambiguity as to the regulatory expectations with respect to independent contractor arrangements involving member organizations. Thus, while the Interpretation has been rewritten to eliminate the requirement that such arrangements be submitted to the Exchange for approval, the intent and substance of the Interpretation has been retained.

As noted above, recent changes to Form U4 now require the identification by registered persons of independent contractor status, thus providing to the Exchange prompt notice and an up-to-date record of such persons.<sup>11</sup> Given this recently established procedural control, it is

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history, education, disciplinary actions, disclosure information, and the self-regulatory organization of registration.

<sup>10</sup> See Form U4, Subsection 2 of Section 15A (Individual/Applicant’s Acknowledgement and Consent).

<sup>11</sup> NYSE Rule 345.12 provides, in part, that an application for a natural person required to be registered with the Exchange shall be submitted on Form U4 and that information on Form U4 must be kept current and shall be updated by filing with the Exchange an amendment to that filing.

proposed that the Interpretation of NYSE Rule 345(a) be amended to eliminate the requirement that member organizations submit separate written representations to the Exchange for approval of proposed independent contractor arrangements. The amended Interpretation would, however, retain current requirements with respect to regulatory expectations regarding such arrangements.

The proposed amendments to the Interpretation would prescriptively retain language, which is currently required to be included in member organizations' requests for approval of each independent contractor arrangement, that would unambiguously confirm that the claim of independent contractor status by a person does not compromise such person's characterization and treatment as an employee of their associated member organization firm for purposes of the rules of the Exchange.<sup>12</sup>

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<sup>12</sup> This is consistent with the Commission's long-standing view that independent contractors (who are not themselves registered as broker-dealers) involved in the sale of securities on behalf of a broker-dealer are "controlled by" the broker-dealer and, therefore, are associated persons of the broker-dealer for all purposes of the Act. See Securities Exchange Act Release No. 44992 (dated October 26, 2001), Footnote 18. While a firm may accept independent contractor status for purposes other than the federal securities laws, such treatment does not alter such person's status as a person associated with a broker or dealer or the firm's responsibility to supervise under the federal securities laws. Further, the Commission does not recognize the concept of "independent contractors" for purposes of the Act, even if such arrangement with an associated person satisfies the criteria for "independent contractor" status for other purposes. See, e.g., In the Matter of Raymond James, Inc. (Initial Decision Release No. 296, Administrative Proceeding File No. 3-11692, September 15, 2005). ("...independent contractor status not relevant to whether independent contractor was acting within the apparent scope of his authority...the Commission does not recognize the concept of independent contractor for purposes of the Exchange Act"); In the Matter of William V. Giordano, (Securities Exchange Act Release No. 36742, January 19, 1996) (in finding that an officer of a broker-dealer firm failed reasonably to supervise such independent contractor, the Commission treated an independent contractor as an "associated person" of the firm within the meaning of Section 3(a)(18) of the Act). In its decision, the Commission noted that while a firm may accept independent contractor status for purposes other than the federal securities laws, such treatment does not alter such person's status as a person associated with a broker or dealer or the firm's responsibility to supervise under the federal securities laws. It also noted that the "Commission does not recognize the concept of 'independent contractors' for purposes of the Exchange Act, even if such arrangement with an associated person satisfies the criteria for 'independent contractor'

Further, while the proposed amendments make clear that independent contractors are fully subject to the same regulatory scheme as registered employees of member organizations, it is proposed that the regulatory attestations currently required to be included in member organization approval requests be prescriptively retained; the purpose being to highlight those aspects of the regulatory scheme that have historically given rise to dispute in connection with independent contractor arrangements. Accordingly, the proposed amendments would continue to specifically require compliance with the following regulatory requirements:

- 1) The member organization must directly supervise and control all activities effected on its behalf by independent contractors to the same degree and extent that it is required to regulate the activities of all other persons registered with such member organization consistent with NYSE Rule 342 and all other applicable Exchange rules. (This would explicitly confirm that the standard of supervision for registered independent contractors is identical to that of registered employees, since the supervisory requirements of NYSE Rule 342 apply to member organizations and their employees.)
- 2) The member organization must ensure that independent contractors are covered by the organization's fidelity insurance bond;<sup>13</sup> determine whether such persons

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status for other purposes.” See Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1572-76 (9<sup>th</sup> Cir. 1990) (broker-dealer is a “controlling person” under Act with respect to its registered representative, even if broker dealer and registered representative contractually agree that representative would be an independent contractor, and thus, broker-dealers were required to supervise their representatives).

<sup>13</sup> These regulations are consistent with the Commission's Division of Market Regulation 1982 letter restating its policy toward independent contractors. In the 1982 letter, the Division stated that independent contractor salesperson whose activities are subject to control by a broker-dealer must be registered with a self-regulatory organization and should be covered by the employer broker-dealer's fidelity bond. See Letter from Douglas Scarff, Director, Division of Market Regulation, to Gordon S. Macklin, NASD,

are subject to a “statutory disqualification” (independent contractor status does not avoid full compliance with statutory disqualification regulations; the independent contractor would be expected to be fingerprinted and subject to a background check in the same manner as any employee); and ensure that independent contractors are in compliance with applicable state Blue Sky provisions.

- 3) The member organization must ensure that any permitted dual employment arrangement involving an independent contractor be in compliance with NYSE Rule 346 (“Limitations- Employment and Association with Members and Member Organizations”).
- 4) The member organization must ensure that the initiation and cessation of independent contractor status and other required amendments be appropriately and timely evidenced via Form U4 or U5,<sup>14</sup> as applicable. It is expected that independent contractor status be indicated on Form U4 at the time of initial registration. If such status is discontinued, either by termination of the relationship or by the independent contractor becoming an employee, prompt amendment of Form U4 would be required.

Further, the proposed amendments would require member organizations to obtain the written attestation of each individual seeking to assert independent contractor status that he or she will be subject to the direct supervision, control and discipline of the member organization, and will be bound by the relevant rules, standards and guidelines of the member organization.

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Charles J. Henry, Chicago Board Options Exchange, Robert J. Birnbaum, American Stock Exchange, and John J. Phelan, NYSE.

<sup>14</sup> Uniform Termination Notice for Securities Industry Registration.



Each prospective independent contractor would also be required to attest in writing that he or she will be deemed an employee of the member organization and, as such, will be fully subject to the jurisdiction of the Exchange. The purpose behind requiring this written concurrence is to better assure that prospective independent contractors are fully aware of the regulatory arrangement they are entering into. The proposed amendments retain an updated<sup>15</sup> version of a “Consent to Jurisdiction” form that would be required for this purpose. Though submittal of executed forms to the Exchange for approval would no longer be required, member organizations would be required to retain them along with the corresponding independent contractor agreement and would be required to timely provide them to the Exchange upon request.

The current Interpretation limits the application of independent contractor status to persons without supervisory responsibilities.<sup>16</sup> The proposed amendments would remove the prohibition against supervisory persons asserting the status of independent contractor, except for those persons designated as principal executive officers (e.g., Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, etc.) who must remain direct employees of the member organization given their unique senior principal executive responsibilities over the various areas of their associated member organization.<sup>17</sup>

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<sup>15</sup> The amendments to “Consent to Jurisdiction” consist of the deletion of dated references (such as the “Constitution” of the Exchange); replacing the term “registered representative” with the term “registered person” to reflect the proposed amendment, discussed below, that would eliminate the prohibition against supervisory persons asserting independent contractor status; and non-substantive changes that improve it stylistically.

<sup>16</sup> That prohibition has been relaxed as to registered representatives “in charge” of an office under NYSE Rule 342.15. See Securities Exchange Act Release No. 48762 (November 7, 2003), 68 FR 64942 (November 17, 2003) (SR-NYSE-2003-26).

<sup>17</sup> See NYSE Rule 311(b)(5) and its Interpretation.

Permitting supervisors to assert independent contractor status would not affect the individual's ability to supervise, nor would it reduce accountability for failure to fulfill their supervisory, regulatory, and other professional obligations. Regardless of whether an individual is deemed an independent contractor, he or she will be required to have the same qualifications and act in the same capacity as any other person similarly charged with supervisory responsibilities. Given these safeguards, and the broad range of activities currently characterized as "supervisory," the restriction on supervisory persons becoming independent contractors would seem to serve no practical nor regulatory purpose. The proposed elimination of the restriction will serve to increase the range of choices available to supervisory persons without detracting from the standards to which they are held.

In sum, the Exchange believes that the proposal will reduce unnecessary administrative burdens on member organizations, while still fully subjecting persons who choose to assert independent contractor status to member organizations' internal policies and procedures, and the jurisdictional reach of the Exchange.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and in particular, with the requirements of Section 6(b)(5)<sup>18</sup> which requires, among other things, that the rules of the Exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and in general to protect investors and the public interest. The proposed amendments are consistent with that section in that they permit firms to structure their employment relationships with registered persons in a manner consistent

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<sup>18</sup> 15 U.S.C. 78f(b)(5).

with Exchange rules and without any diminution of Exchange jurisdiction and oversight with respect to their activities.

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

The Exchange believes that the proposal does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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

Comments were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act.

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NYSE-2006-05 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSE-2006-05. 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 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 NYSE. 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-2006-05 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

Nancy M. Morris  
Secretary

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<sup>19</sup> 17 CFR 200.30-3(a)(12).