

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52403; File No. SR-NASD-2003-104)

September 9, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendment Nos. 1, 2, 3, 4, 5 and 6 thereto Relating to Proposed Uniform Definition of “Branch Office” under NASD Rule 3010(g)(2)

I. Introduction

On July 2, 2003, the National Association of Securities Dealers, Inc. (“NASD”) 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 revise the definition of “branch office” set forth in NASD Rule 3010(g)(2) and to adopt NASD IM-3010-1 to provide guidelines on factors to be considered by a member firm in conducting internal inspections of offices. On October 21, 2003, NASD amended the proposed rule change.³ On December 8, 2003, NASD amended the proposed rule change.⁴

The proposed rule change, as amended by Amendment Nos. 1 and 2, was published for comment in the Federal Register on December 16, 2003.⁵ The Commission received 847

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Kosha K. Dalal, Assistant General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation (“Division”), Commission, dated October 21, 2003 (“Amendment No. 1”).

⁴ See letter from Kosha K. Dalal, Assistant General Counsel, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated December 8, 2003 (“Amendment No. 2”).

⁵ See Securities Exchange Act Release No. 48897 (December 9, 2003), 68 FR 70059.

comment letters on the proposal, as amended.⁶ On June 29, 2004, NASD submitted a response

⁶ See letters from Stephen A. Batman, CEO, 1st Global Capital Corp., dated January 5, 2004 (“1st Global Letter”); Mario DiTrapani, President, Association of Registration Management, dated January 6, 2004 (“ARM Letter”); Carl B. Wilkerson, Chief Counsel, Securities & Litigation, American Council of Life Insurers, dated December 23, 2003 (“ACLI Letter”); Carl B. Wilkerson, Vice President & Chief Counsel, Securities & Litigation, American Council of Life Insurers, dated October 5, 2004 (“ACLI Letter 2”); Charles Barley, dated January 21, 2004 (“Barley Letter”); Mike Becher, dated January 21, 2004 (“Becher Letter”); Rod Bieber, dated January 21, 2004 (“Bieber Letter”); Sherri Branson, Agent, State Farm Insurance Companies, dated January 26, 2004 (“Branson Letter”); John R. Claborn, John R. Claborn & Associates, dated January 21, 2004 (“Claborn Letter”); Charles Ehlert, Rural Insurance Companies, received February 12, 2004 (“Ehlert Letter”); Lawrence J. Fowler, Jr., CLU, LUTCF, Nationwide, dated February 2, 2004 (“Fowler Letter”); Michael Garcia, dated January 20, 2004 (“Garcia Letter”); Bob Geis, CLU, Registered Representative, AXA Network, dated January 28, 2004 (“Geis Letter”); Arthur K. Gruber, CLU, Registered Representative, AXA Advisors, LLC, dated January 23, 2004 (“Gruber Letter”); Richard A. Gurdjian, dated January 20, 200 (“Gurdjian Letter”); Clark Hall, dated January 21, 2004 (“Hall Letter”); Joan M. Halstead, CLU, REBC, ChFC, Chartered Financial Consultant, Halstead Financial Associates, dated January 21, 2004 (“Halstead Letter”); Karen R. Hammond, ChFC, The Hammond Agency, Inc., dated January 21, 2004 (“Hammond Letter”); Jeffrey K. Hoelzel, MTL Equity Products, Inc., dated January 28, 2004 (“Hoelzel Letter”); Raymond Howen, Rural Insurance Companies, received February 11, 2004 (“Howen Letter”); Edwin P. Morrow, CLU, ChFC, CFP, RFC, President and CEO, International Association of Registered Financial Consultants, Inc., dated January 21, 2004 (“IARFC Letter”); Gene Imke, dated January 30, 2004 (“Imke Letter”); Thomas R. Moriarty, President, InterSecurities, Inc., dated January 6, 2004 (“InterSecurities Letter”); Jim Jacobsen, State Farm, received February 9, 2004 (“Jacobsen Letter”); Michael Lisle, Mutual of Omaha Insurance Company, dated January 21, 2004 (“Lisle Letter”); Carl Lundgren, received March 30, 2004 (“Lundgren Letter”); Peter J. Mersberger, Mersberger Financial Group, Inc., dated January 27, 2004 (“Mersberger Letter”); Leonard M. Bakal, Vice President and Compliance Director, Metropolitan Life Insurance Company, dated January 14, 2004 (“MetLife Letter”); Gary A. Sanders, National Association of Insurance and Financial Advisors, dated January 29, 2004 (“NAIFA Letter”); Ralph A. Lambiase, NASAA President and Director, Connecticut Division of Securities, North American Securities Administrators Association, Inc., dated January 6, 2004 (“NASAA Letter”); David Niederbaumer, CLU, ChFC, Financial Associate, and Matt Niederbaumer, Financial Associate, Thrivent Financial for Lutherans, dated January 30, 2004 (“Niederbaumer Letter”); Kathy Northrop, dated January 20, 2004 (“Northrop Letter”); Michael Leahy, President, NYLIFE Securities Inc., dated January 29, 2004 (“NYLIFE Letter”); Gerald J. O’Bee, CLU, ChFC, CLTC, CSA, Insurance and Financial Services, MassMutual Financial Group, dated January 26, 2004 (“O’Bee Letter”); Walter Olshanski, dated January 21, 2004 (“Olshanski Letter”); Minoo Spellerberg, Compliance Director, Princor Financial Services Corporation, dated February 6, 2004 (“Princor

to the comment letters.⁷ On September 20, 2004, NASD amended the proposed rule change (“Amendment No. 3”).⁸ On March 21, 2005, NASD amended the proposed rule change (“Amendment No. 4”).⁹ On June 1, 2005, NASD amended the proposed rule change

Letter”); Minnie Whitmire, Registrations Supervisor, Raymond James & Associates, Inc., dated January 12, 2004 (“Raymond James Letter”); George Nelson Ridings, ChFC CLU, dated January 27, 2004 (“Ridings Letter”); Walter Scott, dated January 21, 2004 (“Scott Letter”); John Polanin, Jr., Chairman, Self-Regulation and Supervisory Practices Committee, Securities Industry Association, dated January 9, 2004 (“SIA Letter”); Christopher Shaw, Vice President & Acting Chief Compliance Officer, Transamerica Financial Advisors, Inc., dated January 6, 2004 (“TFA Letter”); John Gilner, Vice President; Henry H. Hopkins, Vice President; and Sarah McCafferty, Vice President, T. Rowe Price Investment Services, Inc., dated January 5, 2004 (“T. Rowe Price Letter”); Paul B. Uhlenhop, Lawrence, Kamin, Saunders & Uhlenhop, L.L.C., dated December 31, 2003 (“Uhlenhop Letter”); Roy D. Vega, Vega Insurance & Financial Services, dated January 21, 2004 (“Vega Letter”); Al Villasenor, Unisure Insurance Services Inc. and Villasenor Insurance Associates, dated January 28, 2004 (“Villasenor Letter”); and Connie Walenta, dated January 21, 2004 (“Walenta Letter”). In addition, the Commission received 756 comment letters from individuals or entities using “Letter Type A” and 45 comment letters from individuals or entities using “Letter Type B,” both of which expressed concerns over the effect the proposed rule change would have on broker-dealers affiliated with life insurance companies. Letter Types A and B are posted on the Commission’s Internet Web site (<http://www.sec.gov/rules/proposed.shtml>).

⁷ See letter from Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated June 29, 2004 (“NASD Response Letter”).

⁸ See letter from Patrice Gliniecki, Senior Vice President and Deputy General Counsel, NASD, to Katherine A. England, Assistant Director, Division, Commission, dated September 20, 2004. In Amendment No. 3, NASD revised the language of NASD Rule 3010(g)(2) to reflect changes made by File No. SR-NASD-2002-162, approved in Securities Exchange Act Release No. 49883 (June 17, 2004), 69 FR 35092 (June 23, 2004). This was a technical amendment and is not subject to notice and comment.

⁹ In Amendment No. 4, NASD: (i) amended the proposed definition of “branch office” set forth in NASD Rule 3010(g)(2)(A) to exclude a member’s main office to conform to the definition proposed by the NYSE in File No. SR-NYSE-2002-34 (NASD rules do not define “main office”). The NASD made this change to its rule so that the rule would be consistent with the NYSE rule and to avoid confusion for dual members; (ii) added new subparagraph (2)(C) to NASD Rule 3010(g) to clarify the rules and regulations applicable to a member’s main office; and (iii) designated proposed new text to Rule 3010(g)(2) as being subparagraph (D). However, Amendment No. 6 deletes the exclusion of a member’s main office from the definition and proposed subparagraph 2(C) to NASD Rule 3010(g) described in items (i) and (ii) above, respectively. See note 11, *infra*.

(“Amendment No. 5”).¹⁰ On August 23, 2005, NASD amended the proposed rule change (“Amendment No. 6”).¹¹ This order approves the proposed rule change, as amended.

II. Description of Proposed Rule Change

NASD currently defines a branch office as any location identified by any means to the public or customers as a location at which the member conducts an investment banking or securities business. The current definition contains the following exclusions: (1) a location identified in a telephone directory, on a business card, or letterhead; (2) a location referred to in a member advertisement; (3) a location identified in a member’s sales literature; and (4) any location where a person conducts business on behalf of the member only occasionally; provided, in each case, that the phone number and address of the branch office or Office of Supervisory Jurisdiction (“OSJ”) that supervises the location is also identified.¹² NASD currently designates

NASD also responded to ACLI Letter II in Amendment No. 4 (“NASD Response Letter 2”). This was a technical amendment and is not subject to notice and comment.

¹⁰ In Amendment No. 5, NASD made minor changes correcting the grammar, markings, and a cross-reference in the text of the proposed rule change. This was a technical amendment and is not subject to notice and comment.

¹¹ In Amendment No. 6, NASD deleted (i) the proposed exclusion from registration as a branch office for main offices of a member and (ii) proposed subparagraph 2(C) to Rule 3010(g), added in Amendment No. 4, in order to maintain a uniform proposed definition of branch office with the NYSE’s proposal. NASD also clarified the effective date of the proposed rule change and made minor technical changes to the rule text. In addition, NASD responded to comments relating to remote traders in Amendment No. 6 (“NASD Response Letter 3”). This was a technical amendment and is not subject to notice and comment.

¹² An office that is designated a “branch office” under NASD rules must pay an annual registration fee and have a branch manager on site. A branch office is further classified as an OSJ if any one of the following enumerated activities occurs at the location: order execution, maintenance of customer funds and securities, final approval of new accounts and advertisements, review of customer orders, and supervision of associated persons at other branch offices. An office that is designated an OSJ must have a registered principal on-site and be inspected on an annual basis. NASD Rule 3010(c) provides that each branch office shall be inspected according to a cycle set forth in the firm’s written supervisory and inspection procedures.

locations from which associated persons work as either branch offices or unregistered locations. This designation primarily affects the supervisory responsibilities of, and the fees paid by, members.

There is currently no uniform approach among regulators for classifying locations from which registered representatives regularly conduct the business of effecting transactions in securities. The Commission, the New York Stock Exchange, Inc. (“NYSE”), NASD and state securities regulators all define the term “branch office” differently and, as a result, a member must comply with multiple definitions in each jurisdiction in which it conducts a securities business. This requires tracking numerous definitions, filing multiple forms to register and/or renew registration of such locations, meeting various deadlines, and continually monitoring each jurisdiction for changes in rules or procedures. Moreover, NASD member firms must register branch offices with the Commission, NASD, and particular state(s) by completing Schedule E to Form BD (“Schedule E”), which NASD staff and state regulators believe does not adequately fulfill their regulatory needs. In addition, according to NASD, members have found Schedule E to be a burdensome and time-consuming method by which to register branch offices.

As a result, NASD has been working with the North American Securities Administrators Association (“NASAA”), and the NYSE to reduce the inconsistencies that exist among the various ways in which locations are defined in order to increase the utility of the Central Registration Depository (“CRD®”) as a central branch office registration system for NASD, other self-regulatory organizations (“SROs”), and states. The parties reached a core proposed uniform definition, which largely tracks the Commission’s definition of “office” in Rules 17a-3 and 17a-4 under the Act (the “Books and Records Rules”).¹³ NASD filed the instant proposed

¹³ 17 CFR 240.17a-3 and 17 CFR 240.17a-4.

rule change and the NYSE filed a proposed rule change containing a substantially similar definition of branch office, but containing an additional limitation on the primary residence exception as discussed below.¹⁴ In addition, NASD has proposed new Form BR in a separate filing, which would permit registration of branch offices through the CRD® system.¹⁵

The instant proposal would define a “branch office” as any location where one or more associated persons of a member regularly conducts the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of any security, or any location held out as such.¹⁶ The proposed rule change would exclude from registration as a branch office: (1) a location that operates as a back office; (2) a representative’s primary residence, provided it is not held out to the public and certain other conditions are satisfied; (3) a location, other than the primary residence, that is used for less than 30 business days annually for securities business, is not held out to the public as an office, and satisfies certain of the conditions set forth in the primary residence exception; (4) a location of convenience used occasionally and by appointment; (5) a location used primarily for non-securities business and from which less than

¹⁴ See Securities Exchange Act Release No. 46888 (November 22, 2002), 67 FR 72257 (December 4, 2002) (SR-NYSE-2002-34). The Commission is simultaneously approving the NYSE’s proposed rule change. See Securities Exchange Act Release No. 52402 (September 9, 2005).

¹⁵ See Securities Exchange Act Release No. 51742 (May 25, 2005), 70 FR 32386 (June 2, 2005) (SR-NASD-2005-030). See also Correction, 70 FR 48802 (August 19, 2005) (including language inadvertently omitted from the first sentence of footnote 3).

¹⁶ Amendment No. 6 deleted the exclusion “other than the main office” from the definition of branch office as initially proposed. The NASD states that this change would supercede any earlier statements made concerning the registration requirements applicable to members’ main offices under NASD rules. The NASD notes that IM-1000-4 addresses the need for members to keep their membership applications current, as well as to properly designate and register offices of supervisory jurisdiction and branch offices. NASD intends to propose future amendments to IM-1000-4, assuming the SEC’s approval of this proposed rule change and the proposed new Form BR. See Amendment No. 6, supra note 11.

25 securities transactions are effected annually; (6) the floor of an exchange; and (7) a temporary location used as part of a business continuity plan.

In developing the proposed definition, NASD sought to provide reasonable exceptions from branch office registration to take into account technological innovations and current business practices without compromising the need for investor protection. NASD believes the proposed exceptions from branch office registration are practically based while still containing important safeguards and limitations to protect investors. Further, the primary residence exception contains significant safeguards, including that: (1) only one associated person or associated persons who are members of the same immediate family and reside at the location may conduct business at such location; (2) the location cannot be held out to the public and the associated person may not meet with customers at the location; (3) neither customer funds nor securities may be handled at that location; (4) the associated person must be assigned to a designated branch office, and the branch office must be reflected on all business cards, stationery, advertisements, and other communications to the public; (5) the associated person's correspondence and communications with the public must be subject to the firm's supervision;¹⁷ (6) electronic communications must be made through the firm's system; (7) all orders must be entered through the designated branch office or an electronic system established by the member and reviewable at such location; (8) written supervisory procedures pertaining to supervision of sales activities conducted at the residence must be maintained by the member; and (9) the member must maintain a list of the residence locations. These limitations closely track the limitations on the use of a private residence in the Books and Records Rules.¹⁸

¹⁷ The Commission notes that all correspondence and communications with the public by an associated person is subject to the firm's supervision.

¹⁸ 17 CFR 240.17a-4(l).

As noted above, the NYSE's initial proposed definition contained an additional limitation on the primary residence exception, which would have limited to 50 the number of business days an associated person would be permitted to work from his primary residence without requiring registration as a branch office.¹⁹ NASD concluded that the 50-business day limitation on the use of a primary residence would not be practical for small firms and independent dealers, and would not provide any added regulatory benefit, and therefore did not include this limitation in the instant proposal. The NYSE subsequently proposed to remove this limitation from its proposed rule change.²⁰

NASD's proposed definition also would exempt from branch office registration a temporary location, other than a primary residence, that is used for securities business less than 30-business days in any calendar year. The limitations on the use of a primary residence described above also would apply to use of a temporary location for conducting securities business.²¹ For purposes of calculating the number of days for this exception, the proposed rule provides that a "business day" would not include any partial business day, provided that the associated person spends at least four hours on such business day at his or her designated branch office during normal business hours.

The proposed definition would exempt "offices of convenience" from branch office registration, provided that associated persons meet customers only occasionally and exclusively by appointment, and that the location not be held out to the public as a branch office. When such office of convenience is located on bank premises, however, signage necessary to comply with

¹⁹ See SR-NYSE-2002-34, supra note 14.

²⁰ See Amendment No. 2 to SR-NYSE-2002-34.

²¹ For purposes of satisfying condition (a) to the temporary location exception, an associated person would be deemed to "reside" at such temporary location.

applicable federal and state laws, rules and regulations, and applicable rules and regulations of NASD, other self-regulatory organizations, and securities or banking regulators would be permitted in order to avoid confusing customers who might otherwise believe that traditional low-risk investments, such as deposits, are being offered by associated persons at such offices on bank premises. In addition, 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 proposed rule also exempts from branch office registration any location that is primarily used to engage in non-securities activities (e.g., insurance) and from which the associated person effects no more than 25 securities transactions in any one calendar year, provided that advertisements or sales literature identifying such location also set forth the location from which the associated person is directly supervised. In addition, such securities activities would be conducted through and supervised by the associated person's designated branch office.

However, notwithstanding the exclusions in NASD Rule 3010(g)(2)(A), any location that is responsible for supervising the activities of persons associated with the member at one or more non-branch locations of the member would be considered to be a branch office.²²

The proposed rule change also sets forth proposed NASD IM-3010-1, which emphasizes the existing requirement that members establish reasonable supervisory procedures and conduct reviews of locations taking into consideration, among other things, the firm's size, organizational structure, scope of business activities, number and location of offices, the nature and complexity

²² See NASD Rule 3010(g)(2)(B). This rule text was added to reflect changes made by File No. SR-NASD-2002-162. This language conforms to similar language proposed by the NYSE in SR-NYSE-2002-34. See supra notes 8 and 14.

of products and services offered, the volume of business done, the number of associated persons assigned to a location, whether a location has a principal on-site, whether the office is a non-branch location, and the disciplinary history of the registered person. The proposed interpretive material notes that members would be required to be especially diligent in establishing procedures and conducting reasonable reviews with respect to non-branch locations.

NASD indicated in Amendment No. 6 that it expects to deploy branch office functionality in CRD® in the Fall of 2005 and that it expects to make the proposed rule change effective the first quarter of 2006.

III. Comment Summary

As noted above, the Commission received 847 comment letters with respect to the proposed rule change.²³ NASD filed a response letter to address concerns raised by the commenters,²⁴ and subsequently filed a second response letter to address comments made in ACLI Letter 2²⁵ and a third response letter to address comments relating to remote traders.²⁶

Several of the commenters applauded NASD for its efforts in creating a uniform definition of branch office,²⁷ agreeing that a uniform definition would have benefits for broker-dealers.²⁸ One commenter stated that “regulatory coordination and cooperation produces effective and efficient regulation that serves the best interests of investors, regulators and member firms alike” and supported NASD’s proposed definition as “a practical definition that

²³ See supra note 6.

²⁴ See supra note 7.

²⁵ See supra note 9.

²⁶ See supra note 11.

²⁷ See ARM Letter, InterSecurities Letter, Princor Letter, and TFA Letter, supra note 6.

²⁸ See Princor Letter, supra note 6. The Princor Letter went on to discuss changes it believed would be necessary to achieve this goal.

takes into account technological innovations and current business practices without compromising the need for investor protection.”²⁹ Several commenters expressed support for the facilitation and streamlining of branch office registration with CRD®,³⁰ stating that it would provide an “efficient and centralized method for members and associated persons to register branch offices” as required by SROs and states.³¹

Commenters responding to the Commission’s specific request for comment on NASD’s primary residence exception and the divergent proposals by NASD and the NYSE with respect to the NYSE’s proposed annual 50-business day limitation on engaging in securities activities from a primary residence, expressed unanimous support for NASD’s approach.³² Commenters expressed the opinion that the rationale for branch office registration should be determined by the types of activities performed at that location, rather than the number of days spent there.³³

A substantial majority of the commenters, including those who submitted Letter Types A and B, expressed general concerns about the effect the proposed rule change would have upon limited purpose broker-dealers affiliated with life insurance companies. Many of these commenters expressed the view that the proposed rule change would have a disproportionate impact on limited purpose broker-dealers, as compared to full-service broker-dealers who conduct their activities from offices that meet NASD’s current definition of branch office.³⁴

²⁹ See SIA Letter, supra note 6.

³⁰ See ARM Letter, NASAA Letter, and SIA Letter, supra note 6.

³¹ See ARM Letter, supra note 6.

³² See ARM Letter, InterSecurities Letter, MetLife Letter, Princor Letter, SIA Letter, T. Rowe Price Letter, and TFA Letter, supra note 6.

³³ See ARM Letter and SIA Letter, supra note 6.

³⁴ See ACLI Letter, ACLI Letter 2, Branson Letter, Ehlert Letter, Fowler Letter, Garcia Letter, Gurdjian Letter, Halstead Letter, Hoelzel Letter, Howen Letter, IARFC Letter,

These commenters pointed out that broker-dealers affiliated with insurance companies perform a much narrower range of services and that the companies with which they are affiliated have structured their operations based on the current definition and would be presented with significant new economic and administrative costs in order to comply with the proposed definition.³⁵ The commenters stated that over 50 percent of NASD’s registered representatives work for broker-dealers affiliated with life insurers,³⁶ and that the proposal therefore would have a significant financial impact on the life insurance industry.³⁷ One commenter represented that the new definition would cause its number of branch offices to increase from 42 to 1,100,³⁸ while another said that it would expect approximately 3,400 additional branch offices,³⁹ in each case resulting in a sharp increase in overall expenses due to increased paperwork and registration fees. One commenter pointed out that this sharp increase in the number of branch offices would necessitate amendment of its NASD membership agreement.⁴⁰ Commenters submitting Letter Type B stated that the proposal would place an “unfair burden on broker-dealers conducting business through many smaller, geographically dispersed non-branch offices.”⁴¹

NASD responded to these concerns, saying that it recognizes that certain firms may be required to register previously unregistered locations under the proposed definition and that, while this “may increase a firm’s registration costs, NASD believes that a firm’s administrative

Imke Letter, Jacobsen Letter, Lisle Letter, Northrop Letter, NYLife Letter, Ridings Letter, and Letter Type A, supra note 6.

³⁵ See, e.g., Letter Type A, supra note 6.

³⁶ See ACLI Letter 2, NAIFA Letter, NYLIFE Letter, and Letter Type B, supra note 6.

³⁷ See NAIFA Letter, NYLIFE Letter, Princor Letter, and Letter Type B, supra note 6.

³⁸ See Princor Letter, supra note 6.

³⁹ See NYLIFE Letter, supra note 6.

⁴⁰ Id.

⁴¹ See Letter Type B, supra note 6.

and supervision costs for all locations should not increase as a result of this proposal.”⁴² Quite the contrary, NASD stated that “the development of a centralized branch office registration system through CRD® will alleviate current registration burdens, thus making branch office registration and renewal a more efficient process.”⁴³

Two commenters stated that NASD has made no attempt to evaluate or quantify the economic burden the proposal would pose,⁴⁴ and stated their belief that NASD should be required to address specifically the economic impact of the proposed rule change on insurance affiliated broker-dealers and individual broker-dealers in geographically dispersed locations and determine how many new branches would be created by the proposed change.⁴⁵ These commenters stated that the new definition would impose unreasonable and unnecessary burdens on competition, and that the proposed rule change does not meet the statutory safeguards for competition set forth in Sections 23(a)⁴⁶ and 15A(b)(6) and (9)⁴⁷ of the Act.⁴⁸ Commenters predicted that the proposed definition would cause enormous structural and economic upheaval.⁴⁹

NASD disagreed with these commenters’ assertions that the proposal is anticompetitive and will unnecessarily add to their costs of doing business. NASD stated that the supervision requirements of NASD Rule 3010 have always applied to all offices, regardless of whether such

⁴² See NASD Response Letter, supra note 7.

⁴³ Id.

⁴⁴ See ACLI Letter, ACLI Letter 2, and NYLIFE Letter, supra note 6.

⁴⁵ See NYLIFE Letter, supra note 6.

⁴⁶ 15 U.S.C. 78w(a).

⁴⁷ 15 U.S.C. 78o-3(b)(6) and (9).

⁴⁸ See ACLI Letter, ACLI Letter 2, and NYLIFE Letter, supra note 6.

⁴⁹ See ACLI Letter 2 and NAIFA Letter, supra note 6.

locations are registered, and that NASD Rule 3100 requires all members to comply with the Commission's Books and Records Rules. NASD stated that the proposed branch office definition does not amend either of these rules.⁵⁰ In NASD Response Letter 2, the NASD stated that "the annual registration fee for branch offices is reasonable and fair, and does not unfairly discriminate against any particular segment of our membership."⁵¹ NASD continued, stating that it "believes that this fee should not create an undue economic burden for an active business location," and affirmed its statement in the Notice that the proposal "does not create an impact on competition that is not necessary or appropriate in furtherance of the purposes of the Act."⁵²

Two commenters noted that whether a location is registered as a branch office has no impact on a firm's responsibility to supervise its registered representatives since broker-dealers are required to visit both registered and non-registered offices on a periodic basis,⁵³ and others likewise stated that the current system is more than adequate.⁵⁴ A number of commenters opined that the proposed rule change constitutes a new fee that is a revenue raiser, and is not intended to provide any additional oversight or support for consumers.⁵⁵ In response to this point, NASD noted that if there are as many new branch offices as commenters suggest, NASD will be facing a significant increase in the number of previously unregistered locations subject to the more rigorous examination protocol of branch offices, requiring NASD to devote additional staff time and resources. In addition, NASD is incurring costs related to the development of the new CRD® branch office registration system and will continue to incur costs associated with the

⁵⁰ See NASD Response Letter, supra note 7.

⁵¹ See NASD Response Letter 2, supra note 9.

⁵² The current annual registration fee for each branch office is \$75. Id.

⁵³ See MetLife Letter and Princor Letter, supra note 6.

⁵⁴ See Bieber Letter and NYLIFE Letter, supra note 6.

⁵⁵ See Bieber Letter and Letter Type B, supra note 6.

maintenance and operation of the new system. Based on these factors, NASD stated that it “believes that NASD’s annual branch office registration fee is reasonable and fair.”⁵⁶

Many commenters, including those submitting comments on Letter Type A, stated that the high administrative burden of the proposed rule change would have a harmful impact on consumers because limited purpose broker-dealers would find it not economically feasible to continue offering variable products and mutual funds to their clients.⁵⁷ The commenters said that this could “only have a harmful impact on consumers since their access to these products, which often constitute an important part of [their] clients’ overall financial planning, will likely be reduced or eliminated.”⁵⁸ NASD responded, stating that “there are certain fundamental costs associated with regulating any branch office, regardless of the size or activity,” and that it believes that assessing the same fee on each branch office results in an equitable allocation of a reasonable fee among its members.⁵⁹

Many commenters also commented on specific aspects of the proposed definition. Several commenters stated that the conditions for the primary residence exception are too restrictive.⁶⁰ Several commenters objected to the requirement that customer funds not be handled at the primary residence, saying that it was too restrictive⁶¹ and that the term “handled”

⁵⁶ Id.

⁵⁷ See Branson Letter, Claborn Letter, Fowler Letter, Garcia Letter, Gruber Letter, Gurdjian Letter, Halstead Letter, Hoelzel Letter, IARFC Letter, Imke Letter, Jacobsen Letter, Lisle Letter, Mersberger Letter, NAIFA Letter, Olshanski Letter, Ridings Letter, Vega Letter, Villasenor Letter, Walenta Letter, and Letter Type A, supra note 6.

⁵⁸ See, e.g., Letter Type A, supra note 6.

⁵⁹ See NASD Response Letter, supra note 7.

⁶⁰ See InterSecurities Letter, Jacobsen Letter, NYLIFE Letter, Princor Letter, TFA Letter, and Letter Type A, supra note 6.

⁶¹ See InterSecurities Letter, MetLife Letter, NYLIFE Letter, Princor Letter, and TFA Letter, supra note 6.

was not sufficiently defined.⁶² One commenter suggested modifying the proposal to include a time limitation or other qualifying parameter for defining the term “handled.”⁶³ Two commenters objected to the requirement that electronic communications be made through the member firm’s system, saying that the requirement is too restrictive and assumes that all firms have and permit email.⁶⁴ These commenters stated that it should be sufficient that the associated person is subject to the firm’s supervision.⁶⁵ Four commenters objected to the requirement that the associated person not meet with customers at the primary residence location,⁶⁶ and suggested that the proposal be modified to require that the associated person not “regularly” meet with customers at that location.⁶⁷

NASD responded to these comments, stating that it “believes strongly that the limitations on the use of a primary residence are important safeguards intended to protect investors.” NASD said that activities outside the scope of the conditions set forth in the proposed definition should be subject to the monitoring and examination by regulators. NASD continued, stating “[m]oreover, to the extent any particular scenario raises questions as to the meaning of any of these limitations, NASD believes such issues can be addressed, as appropriate, through its interpretive process without requiring amendment to the proposed rule.”⁶⁸

One commenter pointed out that the definition would deem remote electronic traders to be conducting a securities business and therefore be required to register as a branch office if they

⁶² See InterSecurities Letter and TFA Letter, supra note 6.

⁶³ See MetLife Letter, supra note 6.

⁶⁴ See InterSecurities Letter and TFA Letter, supra note 6.

⁶⁵ Id.

⁶⁶ See ARM Letter, MetLife Letter, Princor Letter, and SIA Letter, supra note 6.

⁶⁷ See ARM Letter, MetLife Letter, and SIA Letter, supra note 6.

⁶⁸ See NASD Response Letter, supra note 7.

were not able to meet the terms of the primary residence exclusion.⁶⁹ In response, NASD reiterated that “to the extent any particular scenario raises questions regarding the application of the rule, NASD will address such issues with members through its interpretative process on a case-by-case basis or through future rulemaking, as appropriate,” rather than granting them a general exemption from branch office registration.⁷⁰ Another commenter noted that certain state rules require on-site registered principals be present in state branches, saying that NASD should coordinate with the state requirements.⁷¹

Several commenters objected to the provision that would exclude a location used primarily for non-securities business from the definition of branch office, provided that less than 25 securities transactions are effected there annually, saying that the numerical limitation seems arbitrarily chosen without a quantifiable foundation and objecting to the lack of an explanation for how the limitation was determined.⁷² Commenters stated that the language was not sufficiently clear and queried how to define “effected,” and stated that the proposed rule change lacks clarity as to whether firms must maintain records to demonstrate the availability of the exception.⁷³ Commenters stated that the proposed definition would place an undue burden on firms to track the number of transactions effected from a particular location.⁷⁴

NASD stated that it believes that the 25-transaction limit is reasonable and necessary to promote investor protection, and that a location that engages in a significant number of securities transactions annually should be subject to examination by regulators to ensure that the activities

⁶⁹ See Uhlenhop Letter, supra note 6.

⁷⁰ See NASD Response Letter 3, supra note 11.

⁷¹ See 1st Global Letter, supra note 6.

⁷² See ACLI Letter 2, InterSecurities Letter, Princor Letter, and TFA Letter, supra note 6.

⁷³ See, e.g., NYLIFE Letter, supra note 6.

⁷⁴ See InterSecurities Letter, NYLIFE Letter, and TFA Letter, supra note 6.

at such location are in compliance with applicable rules and regulations.⁷⁵ NASD stated that, with respect to the term “effects,” the meaning is fact specific, and NASD “will address these interpretive issues with members on a case-by-case basis, as appropriate.”⁷⁶

Two commenters pointed out that no effective date was provided,⁷⁷ while others stated that the proposed branch office definition should not be bifurcated from the proposed Form BR.⁷⁸ NASD expects to make the proposed rule change effective the first quarter of 2006, following the implementation of proposed Form BR and the accompanying deployment of branch office functionality in CRD®, which it believes will occur in the Fall of 2005.⁷⁹

A number of commenters suggested amendments to the proposal. Many of the commenters concerned about the impact the new definition would have on limited purpose broker-dealers affiliated with insurance companies requested that the filing fee be waived for current non-branch offices that become branch offices under the new definition.⁸⁰ Three commenters suggested that NASD provide a permanent exclusion from the branch office definition for non-branch locations distributing variable contracts.⁸¹ In response to these comments, NASD stated that, while it recognizes that “life insurance broker-dealers operate with a different business model than many large, wirehouse, full-service firms, NASD believes there

⁷⁵ See NASD Response Letter, supra note 7.

⁷⁶ Id.

⁷⁷ See InterSecurities Letter and TFA Letter, supra note 6.

⁷⁸ See ACLI Letter 2, NYLIFE Letter, and TFA Letter, supra note 6.

⁷⁹ See Amendment No. 6, supra note 11.

⁸⁰ See Branson Letter, Claborn Letter, Fowler Letter, Garcia Letter, Gruber Letter, Gurdjian Letter, Halstead Letter, Hoelzel Letter, IARFC Letter, Imke Letter, Jacobsen Letter, Lisle Letter, Mersberger Letter, NAIFA Letter, Olshanski Letter, Ridings Letter, and Letter Type A, supra note 6.

⁸¹ See ACLI Letter 2, Ehlert Letter, and Howen Letter, supra note 6.

is no basis for recognizing a separate category of broker-dealers in connection with the registration of branch offices.”⁸²

Many of these commenters also requested an increase in the number of transactions that may be effected from a location used primarily for non-securities business before that location is considered a branch office.⁸³ One of these commenters suggested that a gross dealer concession should be used as a threshold for registration because it would allow for easy tracking by the broker-dealer and satisfactory criteria for regulators in registered offices over a certain size.⁸⁴ As discussed above, NASD responded to these comments stating that it believes that the 25-transaction limit is reasonable and necessary to promote investor protection.⁸⁵

Many of the commenters urged the Commission to reject the proposed rule change⁸⁶ and many suggested that NASD maintain the current branch office registration.⁸⁷ One of these commenters stated that NASD’s current branch office definition provides the necessary

⁸² See NASD Response Letter, supra note 7.

⁸³ See Branson Letter, Fowler Letter, Garcia Letter, Gruber Letter, Gurdjian Letter, Halstead Letter, Hoelzel Letter, IARFC Letter, Imke Letter, Jacobsen Letter, Lisle Letter, Mersberger Letter, NAIFA Letter, Olshanski Letter, Princor Letter, Ridings Letter, and Letter Type A, supra note 6.

⁸⁴ See 1st Global Letter and Princor Letter, supra note 6.

⁸⁵ See NASD Response Letter, supra note 7.

⁸⁶ See Branson Letter, Claborn Letter, Ehlert Letter, Fowler Letter, Garcia Letter, Geis Letter, Gruber Letter, Gurdjian Letter, Halstead Letter, Hoelzel Letter, Howen Letter, IARFC Letter, Imke Letter, Jacobsen Letter, Lisle Letter, Mersberger Letter, NAIFA Letter, Northrop Letter, O’Bee Letter, Olshanski Letter, Ridings Letter, Scott Letter, Letter Type A and Letter Type B, supra note 6.

⁸⁷ See ACLI Letter 2, Branson Letter, Claborn Letter, Fowler Letter, Garcia Letter, Geis Letter, Gruber Letter, Gurdjian Letter, Halstead Letter, Hoelzel Letter, IARFC Letter, Imke Letter, Jacobsen Letter, Lisle Letter, Mersberger Letter, NAIFA Letter, Northrop Letter, Olshanski Letter, Princor Letter, Ridings Letter, Letter Type A and Walenta Letter, supra note 6.

safeguards to protect investors,⁸⁸ while another queried why NASD’s current definition was not selected as the uniform definition.⁸⁹ Another commenter stated that the recent amendments to Rule 17a-4 provide sufficient regulatory oversight.⁹⁰ NASD responded that the new branch office registration system will allow NASD and other regulators to associate every registered representative with a specific branch office, a feature that is unavailable under the current system, and that this will provide an “essential tool for regulators when conducting examinations, reviewing customer complains, or taking enforcement actions.” NASD also stated that the uniform definition would allow for the development of a centralized branch office registration system through CRD® that will allow regulators to quickly and efficiently access this information and keep it current.⁹¹ NASD continued, stating that it “strongly believes that the Proposal serves a legitimate regulatory purpose and that the impact on competition to certain member firms as a result of the Proposal is both necessary and appropriate in furtherance of these legitimate regulatory purposes.”⁹²

IV. Discussion and Commission’s Findings

After careful consideration of the proposed rule change, the comment letters, and NASD’s responses to the comment letters, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.⁹³ The Commission believes that the

⁸⁸ See Princor Letter, supra note 6.

⁸⁹ See ACLI Letter 2, supra note 6.

⁹⁰ See NYLIFE Letter, supra note 6.

⁹¹ See NASD Response Letter 2, supra note 9.

⁹² Id.

⁹³ In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

proposed rule change is consistent with Section 15A(b) of the Act,⁹⁴ in general, and furthers the objectives of Section 15A(b)(6),⁹⁵ in particular, 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 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 and appropriate for NASD to reexamine how it determines whether business locations need to be registered as branch offices of broker-dealer members. The Commission also supports NASD, the NYSE, and state securities regulators' joint, regulatory effort to eliminate inconsistencies and duplication in developing a uniform definition of "branch office." The Commission believes that such regulatory coordination and cooperation should 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 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.

⁹⁴ 15 U.S.C. 78o-3(b).

⁹⁵ 15 U.S.C. 78o-3(b)(6).

The Commission commends the NASD for reiterating the responsibility of firms to supervise their associated persons, regardless of their location, and is concerned by the statements of some commenters that this proposed rule change will impose additional supervisory duties on them. The Commission reminds all broker-dealers of their statutory duty to supervise.⁹⁶ Furthermore, the Commission believes 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. The Commission is cognizant of the concerns raised by the ACLI and others in the insurance industry who are also in the securities industry. However, the Commission is also aware that firms with large numbers of associated persons located in smaller, geographically dispersed offices provide additional supervisory challenges, and will require NASD to devote additional staff time and resources to their oversight, once these offices become subject to the more rigorous examination protocol of branch offices.

Furthermore, the Commission believes that the seven proposed exceptions to registering as a branch office will recognize current business, lifestyle, and surveillance practices and provide associated persons with additional flexibility. 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 while providing certain safeguards and limitations to protect investors. In this regard, the Commission supports NASD's decision to omit the proposed 50-business day limitation on working from a primary residence from NASD's proposed definition, and the NYSE's subsequent removal of this limitation from its proposed definition. Moreover,

⁹⁶ See Section 15(b)(4)(E) of the Act. 15 U.S.C. 78q(b)(4)(E).

the definition also would 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 believes it reasonable for NASD not only to propose conditions on the primary residence and temporary location exceptions (e.g., that the location cannot be held out to the public as an office, and that neither customer funds nor securities can be handled there), but also to set forth the interpretive material in proposed NASD IM-3010-1 to emphasize members' requirements to establish reasonable supervisory procedures and conduct reviews of locations taking into account the factors such as those enumerated therein.

In addition, under both exceptions noted above, NASD 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 NASD to monitor and ensure that, where the 30-business day (other location) exemption is used by associated persons, members maintain records adequate to demonstrate compliance with the "business day" limitations.

Finally, the Commission believes it is reasonable for NASD to implement the proposed branch office definition following the commencement of the branch office registration system on the CRD®. This should allow a smooth transition to the new branch office registration system by, as NASD submits, providing members sufficient time to transition to the proposed new Form BR and associated filing protocols, before making the new definition effective.

V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and rules and regulations thereunder applicable to a national securities association, and, in particular, Section 15A(b) of the Act.⁹⁷

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁹⁸ that the proposed rule change (SR-NASD-2003-104), as amended by Amendment Nos. 1 through 6, is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹⁹

Jonathan G. Katz
Secretary

⁹⁷ 15 U.S.C. 78o-3(b).

⁹⁸ 15 U.S.C. 78s(b)(2).

⁹⁹ 17 CFR 200.30-3(a)(12).