

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52850; File No. SR-NYSE-2004-51)

November 29, 2005

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 Thereto Relating to a Proposed Interpretation to Rule 342 (Offices – Approval, Supervision, and Control)

I. Introduction

On September 3, 2004, the New York Stock Exchange, Inc. (“NYSE” or the “Exchange”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”),¹ and Rule 19b-4 thereunder,² a proposed Interpretation of Exchange Rule 342 (Offices – Approval, Supervision, and Control) to permit the waiver of the qualified resident branch office manager requirement for “limited purpose offices” with more than three registered representatives (“RRs”). On September 28, 2005, the Exchange filed Amendment No. 1 to the proposed rule change, replacing the original filing in its entirety.³ The proposed rule change was published for comment in the Federal Register on October 25, 2005.⁴ The Commission received no comments regarding the proposal. This order approves the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 more fully describes the factors to be used in determining whether a location qualifies as a limited purpose office, as well as how those factors will be considered by the Exchange when examining an application for a limited purpose office status. The proposed rule change is described in its entirety in Section II below.

⁴ See Securities Exchange Act Release No. 52640 (October 19, 2005), 70 FR 61672 (October 25, 2005).

II. Description of Proposed Rule Change

Currently, except for “small offices,”⁵ all member and member organization branch offices are required to have an on-site qualified manager. According to the Exchange, member organizations with branch offices that have a limited scope of activities, but that do not meet the definition of “small office” under the Interpretation, have approached the Exchange seeking relief from the requirement that such offices have a qualified branch office manager on-site. The Exchange explains that there has been a large increase in the number of small, multi-function offices that offer a combination of services related not only to securities brokerage, but also to banking and insurance products. In fact, many banks and insurance companies with broker-dealer alliances or affiliates often “dually employ” their personnel with the registered broker-dealer. Because the dually employed persons often primarily conduct business (e.g., banking and insurance) other than broker or dealer activities, they typically physically remain on bank and insurance company premises. However, because they are employees of the registered broker-dealer as well, the location is considered a branch office pursuant to NYSE Rule 342 and must have an on-site qualified manager if more than three RRs are employed there.

According to the Exchange, advances in technology have resulted in increasingly sophisticated surveillance capabilities that enable Exchange members and member organizations to more effectively supervise and control the business activities of their associated persons in branch offices from remote locations, such as another branch office or a firm’s main office. For example, supervisors and firms use centralized communication networks to monitor their

⁵ The Interpretation of NYSE Rule 342.15 limits a small office to a total of three RRs. Small offices that serve an order-taking function only and have no operational facilities are not required to have a qualified manager on-site if they are under the close supervision of the main office or other designated branch offices. See NYSE Rule Interpretation 342.15/01-02. In addition, supervision and control procedures must be made part of the member’s or member organization’s written plan of supervision.

employees' activities and communication with customers, as well as the trading and handling of funds in customer accounts serviced in branch offices. The use of surveillance systems and exception reports that are linked to the broker-dealer's internal order management system further enhances this remote supervision.

Given these surveillance and monitoring capabilities, and the often-limited scope of securities-related business activities conducted in many offices, the Exchange believes that the requirement to have an on-site qualified branch office manager may often be neither practical nor necessary for its members. Consequently, the Exchange re-examined its "four-or-more" standard for requiring on-site supervision, and proposed an alternative system for granting regulatory relief currently available only to small offices.

The proposed rule change sets forth a process by which Exchange members and member organizations may seek a waiver of the on-site branch office manager requirement for "limited purpose offices," which are a proposed new category of offices that have more than three RRs and conduct limited securities-related business activities. Under the proposed rule change, members and member organizations seeking a waiver of the on-site qualified branch office manager requirement for limited purpose offices would be required to provide a written plan of risk-based supervision and control acceptable to the Exchange. Notwithstanding the grant of a waiver, all limited purpose offices would be required to be under the close supervision and control of a qualified person, as defined under NYSE Rule 342.13, at the main office or other designated branch office.

The proposed Interpretation sets forth factors to be used in determining whether a location qualifies as a limited purpose office and the supervisory requirements for each such office, including:

- (i) the number of registered persons in the office (the RR to offsite Branch Office Manager ratio), their registration category, and the functions they perform (the nature and level of the RRs' responsibilities would be taken into account);
- (ii) the scope and types of business activities conducted (in general, the nature of business should not pose special risks or otherwise warrant on-site supervision);
- (iii) the nature and complexity of products and services offered (likewise, the products and services offered should not pose special risks or otherwise warrant on-site supervision);
- (iv) the volume of business done (e.g., annual revenues, number of transactions, number of customers, etc. Locations with high activity levels would generally be deemed more likely to require an on-site manager);
- (v) the adequacy of procedures to supervise the limited purpose office activities; and
- (vi) the adequacy and independence of systems and supervisory persons for regular and "for cause" internal and third party inspections and audits.⁶

With respect to factors (v) and (vi) above, the Exchange expects members and member organizations to present a system of supervision and control that is reasonably designed to detect and prevent regulatory violations and that otherwise meets the requirements of NYSE Rule 342. Such a system should include, but is not limited to, the following elements, where applicable: (1) clearly articulated policies and procedures, and sufficient resources to implement them; (2) systematic monitoring of activity using routine and exception reporting criteria; (3) an appropriate system of follow-up and review if "red flags" are detected, and mechanisms for verifying that deficiencies are corrected; (4) routine and "for cause" inspections, including

⁶ See also NYSE Info Memo 04-38 regarding independence of supervision and internal controls.

possible use of unannounced surprise inspections; (5) offsite monitoring of trading, handling of funds, and use of personal computers; (6) adequate designation of supervisors and clearly delineated supervisory responsibilities, including a system of review and follow-up to ensure that such supervision is sufficiently independent and is diligently exercised; (7) monitoring of outside business activities and outside accounts; (8) monitoring and surveillance of internal and external communications; and (9) the education and training of RRs and their supervisors to ensure they understand their responsibilities under the firm's procedures and all applicable securities laws.

In addition to the elements enumerated above, members and member organizations should also take into consideration relevant guidance provided by the Exchange and other regulatory bodies when developing their supervisory plan for a proposed limited purpose office.⁷

All of the above factors will be considered as a whole to determine whether an application for limited purpose office status should be granted. However, any one factor could cause an application to be delayed or rejected by the Exchange if it raises a substantive issue with respect to the appropriateness or advisability of a remote supervisory arrangement. If an application for limited purpose office status encompasses more than one office, pursuant to a categorical description or plan, the member organization must submit the proposed list of prospective offices so as to disclose the scope of the request.

In addition, members and member organizations will be responsible for maintaining a readily available, current and accurate list of all locations either specifically approved and designated by the Exchange as a limited purpose office, or otherwise designated as such pursuant to a general categorical description or plan approved by the Exchange. Further, any material

⁷ See, e.g., NYSE Info Memo 04-38 (Amendments to Rules 342, 401, 408 and 410 Relating to Supervision and Internal Controls) (July 26, 2004); SEC Division of Market Regulation Staff Legal Bulletin No. 17: Remote Office Supervision (March 19, 2004).

change with respect to the representations made by any member or member organization pursuant to the proposed Interpretation with respect to any location so approved and designated must be promptly brought to the attention of the Exchange for reconsideration.

III. Discussion and Findings

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange.⁸ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Exchange Act,⁹ which requires, among other things, that the rules of a national securities exchange be 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.

According to the Exchange, many broker-dealer business models are becoming more reliant on offices of more than three RRs that service geographically isolated locations, but do not offer a full line of securities products and services. Given that the proposed safeguards are designed to promote effective supervisory procedures, the Commission believes it is reasonable for the Exchange to have more flexibility and discretion to determine whether a qualified on-site branch office manager is necessary for offices that engage in a limited scope of securities-related business activity. The Commission also believes that the proposed Interpretation strikes an appropriate balance between providing flexibility to the Exchange to accommodate the evolving business models of its members, while at the same time setting parameters to ensure that limited purpose offices will continue to be effectively supervised. To further ensure that such offices

⁸ 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).

⁹ 15 U.S.C. 78f(b)(5).

receive effective remote supervision, the Commission expects the Exchange to review plans of risk-based supervision and control for limited purpose offices and their implementation as part of the Exchange's regular examination of members and member organizations.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act¹⁰ that the proposed rule change (SR-NYSE-2004-51) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Jonathan G. Katz
Secretary

¹⁰ 15 U.S.C. 78s(b)(2).

¹¹ 17 CFR 200.30-3(a)(12).