

Notice to Members

OCTOBER 2005

SUGGESTED ROUTING

Continuing Education
Legal & Compliance
Operations
Registered Representatives
Registration
Senior Management
Training

KEY TOPICS

Branch Office Definition
Branch Office Registration
Central Registration Depository (CRD® or Web CRD)
Form BR (Uniform Branch Office Registration Form)
IM-3010-1
Internal Inspections
Rule 3010
Supervision

GUIDANCE

Branch Office Definition

SEC Approves Uniform Branch Office Definition and Related Interpretive Material; **Effective Date: May 1, 2006**

Executive Summary

On September 9, 2005, the Securities and Exchange Commission (SEC) approved (1) amendments to Rule 3010(g)(2) to revise the definition of “branch office” (Uniform Definition); and (2) adoption of IM-3010-1 to provide guidelines on factors to be considered by a member in conducting internal inspections of offices.¹ The SEC simultaneously approved amendments to the New York Stock Exchange, Inc.’s (NYSE) Rule 342 (Offices—Approval, Supervision and Control) to provide a new, uniform industry definition of the term “branch office.”²

In addition, there has been a coordinated effort by regulators to develop a new centralized branch office registration system through the Central Registration Depository (CRD) to provide a more efficient, standardized method for members to register branch office locations as required by the rules and regulations of states and self-regulatory organizations (SROs), including NASD. To facilitate the development of this system, NASD filed a rule proposal with the SEC to adopt new Form BR, which will replace Schedule E of the Form BD, the current NYSE Branch Office Application Form, and certain state branch office forms.³ The SEC approved such rule filing on September 30, 2005.⁴ Form BR will enable firms to register or report⁵ branch offices electronically with NASD, the NYSE and states that require branch registration or reporting, via a single filing through the CRD system.⁶

The amendments are part of NASD's rule modernization initiative to streamline and update NASD rules while preserving investor protections. The amendments establish a broader national standard and are the product of a coordinated effort among regulators to reduce inconsistencies in the definitions used by the SEC, NASD, the NYSE, the North American Securities Administrators Association (NASAA) and state securities regulators to identify locations where broker-dealers conduct securities or investment banking business.

A copy of the amended rule text is attached hereto as Exhibit A.

Effective Date

The amendments will become effective on **May 1, 2006**. The current definition of "branch office" as set forth in Rule 3010(g)(2) will remain in effect until **April 30, 2006**.

Questions/Further Information

Questions concerning this *Notice* may be directed to Chip Jones, Vice President, Registration and Disclosure (RAD), at (240) 386-4797; Richard E. Pullano, Associate Vice President/Chief Counsel, RAD, at (240) 386-4821; or Kosha K. Dalal, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-6903.

Background and Discussion

Background of Amendments

Historically, various regulatory bodies have defined the term "branch office" differently. The conflicting requirements that resulted from such disparate definitions created regulatory burdens on members, such as the need to file different application forms with multiple regulatory organizations in order to register or renew the registration of branch office locations, as well as having to coordinate differing registration and notification filing deadlines. The amendments are intended to alleviate these burdens by standardizing the criteria to be applied when determining whether or not a business location requires registration as a branch office.

In addition to the amendments discussed in this *Notice*, there has similarly been a coordinated effort by NASD, the NYSE and NASAA to standardize the branch office application process. Specifically, the securities industry will shortly be making the transition to a centralized, CRD-based branch office application system that will allow members, via new Form BR, to submit a single filing in order to simultaneously fulfill the branch office reporting and/or registration requirements of NASD, the NYSE and most states.⁷ In this regard, firms will also benefit from online work queues, electronic notifications and other features available through the CRD system.⁸

Current Definition of “Branch Office” (in effect until April 30, 2006)

Prior to the effective date of the amendments, NASD’s current definition of “branch office” continues in effect. As of May 1, 2006, the Uniform Definition becomes effective, and members must have a completed Form BR filed for each location that meets the amended definition.

NASD designates locations from which associated persons work as either branch offices or unregistered offices/locations. As currently defined, a “branch office” is 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 definition provides that the following activities will not be deemed “holding out” and, therefore, will not trigger registration of the location as a branch office: (1) a location identified in a telephone directory, 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, the phone number and address of the branch office or Office of Supervisory Jurisdiction (OSJ) that supervises the location is also identified.

A branch office is further classified under Rule 3010(g)(1) as an OSJ if any one of the following enumerated activities occurs at the location: (1) order execution and/or market making; (2) structuring of public offerings or private placements; (3) maintaining custody of customers’ funds and/or securities; (4) final acceptance (approval) of new accounts on behalf of the member; (5) review and endorsement of customer orders; (6) final approval of advertising or sales literature for use by associated persons; or (7) responsibility for supervising associated persons at other branch offices.⁹ An office that is designated an OSJ must have a registered principal on-site and be inspected on an annual basis.¹⁰

Uniform Definition (to become effective May 1, 2006)

The language of the Uniform Definition substantially mirrors the SEC’s definition of “office” in its “Books and Records” rules (see Rules 17a-3 and 17a-4)¹¹ under the Securities Exchange Act of 1934.¹² The Uniform Definition does not alter or affect the obligations of a member to comply with the minimum requirements of the Books and Records Rules which specify the records broker-dealers must make, and how long those records and other documents relating to a broker-dealer’s business must be kept.

The Uniform Definition defines 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 that is held out as such.

Exemptions from Branch Office Registration

In developing the Uniform Definition, regulators understood the need to provide reasonable exceptions from branch office registration that take into account technological innovations and current business practices without compromising the need for investor protection. NASD believes the exceptions from branch office registration are practically based while still containing important safeguards and limitations to protect investors.

Accordingly, as further detailed below, the Uniform Definition excludes from registration as a branch office: (1) a location that operates as a non-sales location/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 which 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 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.

Non-Sales Locations/Back Offices

Rule 3010(g)(2)(A)(i) exempts non-sales locations from branch office registration. Such locations must be established solely for customer service and/or back office functions and may not be held out to the public as a branch office. No sales activities may be conducted from a non-sales location, which is to say that associated persons conducting business on behalf of a member from such locations may not recommend the purchase or sale of securities, otherwise communicate with the public, accept orders for the purchase or sale of securities or execute such orders.

Primary Residences

Rule 3010(g)(2)(A)(ii) exempts from the definition of branch office any location that is the associated person's primary residence. Only one associated person, or multiple associated persons who reside at the location and are members of the same immediate family, may conduct business from the location. Each member must maintain a current list of any such locations, which are subject to the following specific safeguards and limitations:

- ◆ The location may not be held out as an office.
- ◆ The associated person(s) may not meet with customers at the location.
- ◆ Neither customer funds nor securities may be handled at the location.
- ◆ The associated person or persons are assigned to a designated branch office, which is reflected on all business cards, stationery, advertisements and other communications to the public.

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- ▶ All communications with the public must be subject to supervisory provisions pursuant to all applicable NASD rules (including, but not limited to, Rule 3010).
 - ▶ Electronic communications must be transmitted through the member's electronic system.
 - ▶ All orders must be entered through the designated branch office or through an electronic system established by the member that is reviewable at such branch office.
 - ▶ Written procedures relating to the supervision of sales activities conducted at the location must be maintained by the member.

Locations Other than Primary Residences

Rule 3010(b)(2)(A)(iii) exempts from branch office registration any location, other than primary residences, provided it is used for securities-related activities less than 30-business days in any calendar year. These would generally include vacation or second homes and other non-primary residences. Such locations are subject to the same criteria imposed upon exempted primary residences (enumerated above).

In the context of this exemption, the term "business day" is defined to exclude any partial day, provided the associated person spends at least four hours of such business day at his or her designated branch office during the time period such office is normally open for business. This is intended to prevent associated persons from regularly conducting business from locations other than their primary residence for the majority of a business day, without such activity being counted towards the 30-business-day limit.

Where the 30-business-day exemption is utilized, members are expected to maintain records adequate to demonstrate compliance with the business day limitations. Once the 30-business day limit has been reached, members will have a 30-calendar-day window to register such locations as branch offices.

Offices of Convenience

Rule 3010(g)(2)(A)(iv) exempts from branch office registration "offices of convenience." An office of convenience is defined as a location where an associated person occasionally and exclusively by appointment meets with customers, provided such location is not held out to the public as an office. An associated person may not establish regular business hours at such location or hold out the location in any way (except for signage required at banks as discussed below). Final approval and execution of transactions must be done through the branch office.

Where such office of convenience is located on bank premises, signage necessary to comply with applicable federal and state laws, rules and regulations, and applicable rules and regulations of the NYSE, other self-regulatory organizations, and securities and banking regulators may be displayed and will not be deemed “holding out” for purposes of this section. This restriction is intended to prevent confusion on the part of customers who might otherwise believe that only traditional, insured bank-related investments are being offered by associated persons through such offices.

Location Used Primarily to Engage in Non-Securities Transactions

Rule 3010(g)(2)(A)(v) exempts from branch office registration locations where associated persons are primarily engaged in non-securities activities (e.g., insurance sales) and from which an associated person effects no more than 25 securities transactions in a calendar year; provided that advertisements or sales literature, including business cards, identifying such location also set forth the locations from which the associated person or persons are directly supervised. All securities transactions originating from such locations must be entered through, and supervised by, the associated person’s designated branch office. Once the 25 securities transaction threshold is exceeded, members will be given a 30-calendar-day window to register such locations as branch offices.

Floor of a Registered National Securities Exchange

Rule 3010(g)(2)(A)(vi) exempts from branch office registration any location on the floor of a registered national securities exchange from which a member conducts a direct access business with public customers.

Temporary Location Used as Part of a Business Continuity Plan

Rule 3010(g)(2)(A)(vii) exempts from branch office registration any temporary location established in response to the implementation of a business continuity plan.¹³

Main Offices

A member’s main office will be required to register as a branch office if it falls within the definition of “branch office.”¹⁴

Offices That Supervise Other Offices

Current Rule 3010(g)(2)(B) provides that notwithstanding the exclusions provided in paragraph (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 is considered to be a branch office. This provision is currently effective and will remain so after the effective date of the Uniform Definition. Further, as noted above, members are reminded that pursuant to Rule 3010(g)(1), any location that is responsible for supervising the activities of persons associated with the member at one or more *branch offices* of the member is an OSJ.

IM-3010-1 (effective May 1, 2006)

NASD staff believes the adoption of the Supervisory Controls Amendments in 2004 established an industry benchmark, imposing high standards regarding member's supervision and supervisory control procedures.¹⁵ However, to further emphasize the requirement that members already have to establish reasonable supervisory procedures and conduct reviews, NASD is adopting new interpretive material, IM-3010-1 (Standards for Reasonable Review). IM-3010-1 provides that each member must conduct a review, at least annually, of the businesses in which it engages, which must be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations and with NASD rules. Each member shall establish and maintain supervisory procedures that must take into consideration, among other things, the member's:

- ◆ size,
- ◆ organizational structure,
- ◆ scope of business activities,
- ◆ number and location of offices,
- ◆ the nature and complexity 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 representatives or associated persons.

The IM notes that members must be especially diligent in establishing procedures and conducting reasonable reviews with respect to non-branch locations.

Interpretive Guidance

NASD expects to publish a *Notice* shortly addressing certain interpretive issues relating to the Uniform Definition.

Timeline and Branch Registration and Reporting

The following is intended to be a brief summary of the transition process to the Form BR and the new branch office registration system. Members are encouraged to refer to *Notice to Members (NTM) 05-66* for more detailed information on how to register offices using the Form BR and the new branch office registration system.

Important Dates to Remember

- ▶ **October 14, 2005:** Last day on which NASD member firms may file a new or amended Schedule E to Form BD through the CRD system.
- ▶ **October 15, 2005 to October 30, 2005:** “Lock-out” Period—There will be a two-week lock-out period beginning October 15, 2005 through October 30, 2005, so that NASD can begin the transition process to the Form BR for branch offices in existence as of the close of business on October 14, 2005. During the lock-out period, NASD will create a “conversion” Form BR on the CRD system for all branch offices in existence as of the close of business on October 14, 2005. NASD will assign a unique branch CRD number to each of these branches and pre-populate the conversion Forms BR with limited information for each of these branches.¹⁶ During this lock-out period, the CRD system will not accept any branch office forms or amendments via any of the current branch office forms or Form BR.
- ▶ **October 31, 2005:** Starting on this date, the new branch office functionality will be available in the CRD system, and firms will be able to file Forms BR for each of their branch offices. Beginning on this date, firms with branch offices in existence prior to the close of business on October 14, 2005 may (1) complete the data fields for each conversion Form BR created by NASD during the lock-out period and (2) file the completed Forms BR through CRD. Also starting on this date, firms may register via the new Form BR any new branch offices opened during the lock-out period or thereafter (*i.e.*, branch offices established on or after October 15, 2005).
- ▶ **May 1, 2006:** Effective Date of Uniform Definition and IM-3010-1—Members must have a complete Form BR for any office that is a “branch office” under the Uniform Definition.

Endnotes

- 1 See Exchange Act Release No. 52403 (September 9, 2005); 70 FR 54782 (September 16, 2005); File No. SR-NASD-2003-104 (Order Granting Approval of Proposed Rule Change Relating to Proposed Uniform Branch Office Definition) (SEC Approval Order).
- 2 See Exchange Act Release No. 52402 (September 9, 2005); 70 FR 54788 (September 16, 2005); File No. SR-NYSE-2002-34 (Order Granting Approval of Proposed Rule Change Relating to Proposed Uniform Branch Office Definition) (SEC NYSE Approval Order).
- 3 See Exchange Act Release No. 51742 (May 25, 2005); 70 FR 32386 (June 2, 2005); File No. SR-NASD-2005-030 (Proposed Form BR (Uniform Branch Office form) and Conforming Changes and Technical Revisions to the Uniform Application for Securities Industry Registration or Transfer (Form U4) and the Uniform Termination Notice for Securities Industry Registration (Form U5)) (March 11, 2005).
- 4 See Exchange Act Release No. 52544 (September 30, 2005).
- 5 Although these terms may be used interchangeably by SROs and/or states, "registration" typically refers to a process that requires an approval by the SRO or state before a branch may begin doing business, whereas "reporting" typically refers to a process by which firms "notice file" or notify an SRO or state of the existence of a branch office, but an approval is not required.
- 6 For information on which states will accept Form BR for branch office registration, see the North American Securities Administrators Association (NASAA) Web site at www.nasaa.org.
- 7 The Form BR replaces Schedule E of the Form BD, the current NYSE Branch Office Application Form (which is currently submitted through the NYSE's Electronic Filing Platform (EFP) System), and certain state branch office forms. Consistent with the uniform form concept, the Form BR will enable firms to register or report branch offices electronically with NASD, the NYSE and states that require branch registration or reporting, via a single filing through the CRD system. For additional information, see Exchange Act Release No. 51742 (May 25, 2005); 70 FR 32386 (June 2, 2005); File No. SR-NASD-2005-030 (Proposed Form BR and Conforming Changes and Technical Revisions to the Form U4 and Form U5) (March 11, 2005). See also SR-NYSE-2005-13 and NYSE Information Memo 04-43, dated August 9, 2004.
- 8 See *Notice to Members 05-66* for more detailed information regarding the new Form BR and the branch office registration system.
- 9 See Rule 3010(g)(2).
- 10 See Rules 3010(a) and (c). Rule 3010(c) further provides that each member shall inspect at least annually any branch office that supervises one or more non-branch locations, and at least every three years any branch office that does not supervise one or more non-branch locations.
- 11 See 17 CFR 240.17a-3 and 17a-4.
- 12 15 U.S.C. 78a et seq.
- 13 For additional information, see Rules 3510 (Business Continuity Plans) and 3520 (Emergency Contact Information). See also *NTM 04-37, SEC Approves Rules Requiring Members to Create Business Continuity Plans and Provide Emergency Contact Information* (May 2004).

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- 14 This rule change supercedes any earlier statements made concerning the registration requirements applicable to members' main offices under NASD rules. 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 OSJs and branch offices. NASD intends to propose future amendments to IM-1000-4 to reflect the SEC's approval of the Uniform Definition and new Form BR.
- 15 See Exchange Act Release No. 49883 (June 17, 2004), 69 FR 35092 (June 23, 2004); SR-NASD-2002-162. See also Exchange Act Release No. 50477 (September 30, 2004), 69 FR 59972 (October 6, 2004); SR-NASD-2004-116. See also *NTM 04-71, Supervisory Controls, SEC Approves New Rules and Rule Amendments Concerning Supervision and Supervisory Controls* (October 2004).
- 16 The conversion process will download the following fields from existing data in CRD or the Investment Advisor Registration Advisory® (IARD), as well as the following data provided by the NYSE and participating states: Branch Address, NASD Branch Number, NYSE Branch Code Number, NYSE Branch Type, NASD/NYSE Supervisor/Person-In-Charge Name and CRD Number, Operational Status and NYSE/Jurisdiction Registration Status.

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EXHIBIT A

3010 Supervision

(g) Definitions

(2) (A) A “branch office” is 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 is held out as such, excluding:

(i) Any location that is established solely for customer service and/or back office type functions where no sales activities are conducted and that is not held out to the public as a branch office;

(ii) Any location that is the associated person’s primary residence; provided that:

a. Only one associated person, or multiple associated persons, who reside at that location and are members of the same immediate family, conduct business at the location;

b. The location is not held out to the public as an office and the associated person does not meet with customers at the location;

c. Neither customer funds nor securities are handled at that location;

d. The associated person is assigned to a designated branch office, and such designated branch office is reflected on all business cards, stationery, advertisements and other communications to the public by such associated person;

e. The associated person’s correspondence and communications with the public are subject to the firm’s supervision in accordance with Rule 3010;

f. Electronic communications (e.g., e-mail) are made through the member’s electronic system;

g. All orders are entered through the designated branch office or an electronic system established by the member that is reviewable at the branch office;

h. Written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member; and

i. A list of the residence locations is maintained by the member;

(iii) Any location, other than a primary residence, that is used for securities business for less than 30 business days in any one calendar year, provided the member complies with the provisions of paragraph (A)(2)(ii)a. through h. above;

(iv) Any office of convenience, where associated persons occasionally and exclusively by appointment meet with customers, which is not held out to the public as an office;*

(v) Any location that is used primarily to engage in non-securities activities and from which the associated person(s) effects no more than 25 securities transactions in any one calendar year; provided that any advertisement or sales literature identifying such location also sets forth the address and telephone number of the location from which the associated person(s) conducting business at the non-branch locations are directly supervised;

(vi) The Floor of a registered national securities exchange where a member conducts a direct access business with public customers; or

(vii) A temporary location established in response to the implementation of a business continuity plan.

(B) Notwithstanding the exclusions provided in paragraph (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 is considered to be a branch office.

(C) The term "business day" as used in Rule 3010(g)(2)(A) shall 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 the hours that such office is normally open for business.

* Where such office of convenience is located on bank premises, signage necessary to comply with applicable federal and state laws, rules and regulations and applicable rules and regulations of the NYSE, other self-regulatory organizations, and securities and banking regulators may be displayed and shall not be deemed "holding out" for purposes of this section.

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IM-3010-1. Standards for Reasonable Review

In fulfilling its obligations pursuant to Rule 3010(c), each member must conduct a review, at least annually, of the businesses in which it engages, which review must be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations and with NASD Rules. Each member shall establish and maintain supervisory procedures that must take into consideration, among other things, the firm's size, organizational structure, scope of business activities, number and location of offices, the nature and complexity 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, the disciplinary history of registered representatives or associated persons, etc. The procedures established and the reviews conducted must provide that the quality of supervision at remote offices is sufficient to assure compliance with applicable securities laws and regulations and with NASD Rules. With respect to a non-branch location where a registered representative engages in securities activities, a member must be especially diligent in establishing procedures and conducting reasonable reviews. Based on the factors outlined above, members may need to impose reasonably designed supervisory procedures for certain locations and/or may need to provide for more frequent reviews of certain locations.

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