

Notice to Members

AUGUST 2002

SUGGESTED ROUTING

CRD
Legal & Compliance
Member Regulation
Operations
Senior Management

KEY TOPICS

Branch Office Definition
Rule Modernization
Rule 3010(g)(2)

REQUEST FOR COMMENT ACTION REQUESTED BY SEPTEMBER 20, 2002

Branch Office Definition

NASD Requests Comment on Proposed Amendments to NASD Rule 3010(g)(2) ("Branch Office Definition");
Comment Period Expires on September 20, 2002

Executive Summary

NASD requests comment from members, investors, and other interested parties on proposed amendments to NASD Rule 3010(g)(2) ("Branch Office Definition"), which were developed collectively by NASD, the New York Stock Exchange, Inc. (the NYSE) and the North American Securities Administrators Association, Inc. (NASAA), with the intention of creating a uniform definition of the term among regulators. Currently, there is no uniform approach among regulators for classifying locations at which securities operations are conducted. The creation of a uniform branch office definition would allow NASD to pursue registration of branch offices through NASD's Central Registration Depository (CRD) system.

NASD seeks comment on the proposed definition of branch office, including on whether the proposed uniform definition: (1) provides greater clarity on when a location is required to be registered as a branch office; (2) provides a cost savings to firms as a result of centralized registration of locations through NASD's CRD system; (3) minimizes regulatory compliance burdens; (4) significantly affects the number of locations that a firm is required to register; and (5) adequately addresses evolving business practices based on technological innovations. Additionally, NASD seeks comment on whether the proposed exceptions to the branch office are appropriate. Commenters are encouraged to provide empirical data where possible to support their views.

Questions/Further Information

Questions concerning this *Notice* may be directed to Kosha Dalal, Assistant General Counsel, Office of General Counsel, NASD

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Regulatory Policy and Oversight, at (202) 728-6903; or questions concerning NASD coordination with the NYSE and NASAA may be directed to Chip Jones, Associate Vice President, NASD Registration and Disclosure, at (240) 386-4797.

Request for Comment

NASD requests comment on the proposed amendments to Rule 3010(g)(2). Comments must be received by September 20, 2002. Members and interested persons can submit their comments using the following methods:

- ▶ mail Attachment B—Request for Comment Form—along with written comments
- ▶ mail written comments
- ▶ e-mail written comments to pubcom@nasd.com
- ▶ submit written comments online on our Web Site (www.nasd.com)

Written comments submitted via hard copy should be mailed to:

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Important Note: The only comments that will be considered are those submitted by mail, e-mail, or those submitted to the NASD Web Site.

Before becoming effective, any rule change developed as a result of responses received to this *Notice* must be approved by the Securities and Exchange Commission.

Background

In July 2001, NASD announced in *Notice to Members 01-35* its intention to move forward with an initiative designed to ensure that NASD rules are as streamlined as possible, and impose the least burden to accomplish their objectives while achieving investor protection. In response to *NASD Notice to Members 01-35*, NASD received 37 comment letters identifying rules that should be the focus of our rule modernization effort. After reviewing these comment letters, in *NASD Notice to Members 02-10* (January 2002), NASD requested comment on certain proposals that were under consideration, including establishing a uniform branch office definition. Of the approximately 65 commenters who responded regarding Rule 3010(g)(2), the responses were overwhelmingly in favor of developing a uniform definition that would allow centralized registration through the CRD system.

Current Definition

NASD Rule 3010(g)(2) defines a branch office generally 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 (“holding out”). The current definition excludes certain locations that only are identified in telephone listings, business cards, or letterhead, or referred to in advertising, or identified in a member’s sales literature, provided that the address and telephone number of the branch office or office of supervisory jurisdiction (OSJ) from which the associated person is supervised is given.

NASD designates locations from which associated persons work, other than the main office, as either branch offices or unregistered locations. This designation primarily affects the supervisory responsibilities of, and the fees paid by, members. An office that is designated a "branch office" under NASD rules must pay an annual registration fee and have onsite supervision by a branch manager. 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 onsite. The proposed uniform definition would not affect or change the definition, or responsibilities, of an OSJ.

Need for Uniformity

Currently, there is no uniform approach among regulators for classifying locations at which securities operations are conducted. NASD, the Securities and Exchange Commission (the SEC), the NYSE, and state regulators define the term (or a similar term) differently. The term also has different significance based on who classifies it. Under NASD rules, for example, the term triggers supervisory obligations and fees and, under the SEC rules, the term triggers record keeping requirements. NASD believes that a uniform definition of the term branch office would reduce regulatory burdens on firms because (1) there would be no need to keep track of varying definitions in numerous jurisdictions; (2) the risk of non-

compliance would be reduced; and (3) a centralized registration process would provide efficiencies.

The SEC's books and records rules, Rule 17a-3 and Rule 17a-4 under the Securities Exchange Act of 1934 ("Exchange Act")(hereinafter the "Books and Records Rules"), specify minimum requirements with respect to the records that broker/dealers must make, and how long those records and other documents relating to a broker/dealer's business must be kept. The proposed branch office definition would not alter or affect the obligations of a firm to comply with the requirements of the Books and Records Rules. The definition proposed here, and agreed upon by representatives of NASAA and the NYSE, largely tracks the definition in the SEC's Books and Records Rules for the term "office."¹

In July 2002, the NASD Board approved publication of this *Notice* seeking comment on the proposed uniform definition. In August 2002, the Board of Directors of the NYSE approved the proposed uniform definition and authorized its staff to file a proposed rule change with the SEC. In addition, NASAA's Broker-Dealer Section Committee has approved the proposed definition. NASAA also has committed to support the adoption of the uniform definition with the various states.

Proposed Definition of "Branch Office"

As proposed, a "branch office" would be any location, other than the main office, where one or more associated persons of a member regularly conduct 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.

The interpretation of what it means to “regularly conduct the business of effecting transactions in, or inducing or attempting to induce the purchase or sale of any security” under the proposed uniform definition would include activities such as: (1) soliciting new accounts or orders; (2) opening new accounts; (3) accepting or entering orders; and (4) conducting seminars for existing or prospective customers. In addition, “holding out” a location would include references to a location on or in business cards, stationery, advertisements, sales literature, and signage that would lead investors to believe that they are dealing with a branch office of a member firm, regardless of whether the location from which the office is supervised is listed on the communication.

The definition of “branch office” would expressly exclude, subject to the satisfaction of certain conditions:

- (1) a location that operates as a back office;
- (2) a representative’s primary residence, provided the residence is used for securities business for less than 50 days annually and not held out to the public;
- (3) a location, other than a primary residence, provided that it is used for securities business for less than 30 days annually and not held out to the public (e.g., a vacation home);
- (4) a location used by a circuit-rider to meet with customers occasionally and exclusively by appointment;

- (5) a location that is primarily used for non-securities business (e.g., by insurance agents to sell non-securities insurance products) and from which the associated person(s) effects no more than 25 securities transactions in any one calendar year;
- (6) the floor of a registered exchange; and
- (7) a temporary location established in response to implementation of a business continuity plan.

See Attachment A for a full description of the conditions that need to be satisfied for each exception to apply.

Comparison of Current Definition vs. Proposed New Definition

The current NASD branch office definition is based on a “holding out” standard (any location identified to the public or customers as a location at which the member conducts an investment banking or securities business). The definition is broad and is not dependent on the number of associated persons working at any particular location. The current definition excludes certain locations held out to the public so long as the identification of such locations is limited and sets forth the address and telephone number of the branch office or OSJ of the firm from which the associated person is directly supervised (for example, a business card or letterhead can list a non-branch location so long as the address and telephone number of the branch office or OSJ is

also listed). Under the proposed uniform definition, this type of exception would no longer exist.

The proposed uniform definition is intended to provide clarity in application and consistency between self-regulatory organizations (SROs) and state securities administrators. Under the proposed definition, any location where one or more associated persons regularly conduct the business of effecting transactions in, or inducing or attempting to induce the purchase or sale of, any security or that is held out as such is subject to registration as a branch office unless the location meets one of the seven specific exclusions. The exclusions are intended to provide firms with the flexibility that today's business environment demands (for example, many associated persons work from home for some part of the year, or conduct business while on vacation).

The chart on the next page briefly compares the two definitions.

Location	Current Definition	Proposed New Definition
Back Office	Subject to registration if the location is identified to the public in any way, including in a business card, letterhead, or identified in sales literature, etc., unless the address and telephone number of the branch office or OSJ is also identified	Specifically excluded from registration so long as no sales activities occur at the location and it is not held out to the public as a branch office
Primary Residence	Subject to registration if the location is identified to the public in any way, including in a business card, letterhead, or identified in sales literature, etc., unless the address and telephone number of the branch office or OSJ is also identified	Specifically excluded from registration so long as the primary residence is used for securities business for less than 50 business days per year and other conditions are satisfied
Vacation Locations	Subject to registration if the location is identified to the public in any way, including in a business card, letterhead, or identified in sales literature, etc., unless the address and telephone number of the branch office or OSJ is also identified	Specifically excluded from registration so long as the location is used for securities business for less than 30 business days per year and other conditions are satisfied
Bank Circuit Rider	Not subject to registration so long as the address and phone number of the branch office or OSJ are also identified	Not subject to registration so long as not held out (signage required by banking regulations is permitted)
Non-securities Business	Subject to registration if the location is identified to the public in any way, including in a business card, letterhead, or identified in sales literature, etc., unless the address and telephone number of the branch office or OSJ is also identified	Not subject to registration so long as location is used primarily to conduct non-securities business (e.g., sell non-security insurance products) and no more than 25 securities transactions are effected in one year and address and phone number of branch or OSJ is identified
Floor of Registered National Securities Exchange	Potentially subject to registration	Not subject to registration
Temporary Location for Business Continuity	Potentially subject to registration	Not subject to registration

Benefits of Proposed New Definition

NASD believes that a uniform definition would benefit member firms by reducing regulatory burdens and costs, without jeopardizing investor protection. In addition, the potential to use the CRD system for centralized registration of branch offices should provide greater clarity, efficiency, and time and potential liability savings resulting from uniformity. Currently, members with numerous offices must register with each individual state that requires registration; in some jurisdictions, failure to timely register can result in significant sanctions.

NASD, therefore, solicits comment on whether to amend the Branch Office Definition as proposed in Attachment A. NASD also solicits comment specifically on whether the proposed uniform definition: (1) provides greater clarity on when a location is required to be registered as a branch office; (2) provides a cost savings to firms as a result of centralized registration of locations through CRD; (3) minimizes regulatory compliance burdens; (4) significantly affects the number of locations that a firm is required to register; and (5) adequately addresses evolving business practices based on technological innovations. Additionally, NASD seeks comment on whether the proposed exceptions to the branch office definition are appropriate. Commenters are encouraged to provide empirical data where possible to support their views.

Endnote

¹ Rule 17a-3(g)(1) under the Exchange Act defines the term “office” to mean any location where one or more associated persons regularly conduct the business of handling funds or securities or effecting any transactions in, or inducing or attempting to induce the purchase or sale, of any security.

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ATTACHMENT A

Proposed New Text of Rule 3010(g)(2) - "Branch Office" Definition

A "branch office" is any location, other than the main office, where one or more associated persons of a member regularly conduct 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, excluding:

- (A) 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;
- (B) any location that is the associated person's primary residence; provided that (i) the location is used for securities business for less than 50 business days in any one calendar year; (ii) only one person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct business at the location; (iii) the location is not held out to the public as an office and the associated person does not meet with customers at the location; (iv) neither customer funds nor securities are handled at that location; (v) 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; (vi) the associated person's correspondence and communications with the public are subject to the firm's supervision; (vii) electronic communications (*i.e.*, e-mail) are made through the member's electronic system; (viii) all orders are entered through the designated branch office; (ix) written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member; and (x) a list of the residence locations are maintained by the member;

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- (C) 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 (B) above;
 - (D) any office of convenience, where associated persons occasionally and exclusively by appointment meet with customers, which is not held out to the public as a branch office (Where such location is on bank premises, only signage required by the Interagency Statement (Statement on Retail Sales of Nondeposit Investment Products required under Banking Regulations) may be displayed);
 - (E) 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 advertisements 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; or
 - (F) the Floor of a registered national securities exchange where a member conducts a direct access business with public customers; and
 - (G) a temporary location established in response to the implementation of a business continuity plan.

The term "business day" as used herein 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.

ATTACHMENT B

Request for Comment Form

We have provided below a form that members and other interested parties may use in addition to written comments. This form is intended to offer a convenient way to participate in the comment process, but does not cover all aspects of the proposal described in the *Notice*. We therefore encourage members and other interested parties to review the entire *Notice* and provide written comments, as necessary.

Instructions

Comments must be received by September 20, 2002. Members and interested parties can submit their comments using the following methods:

- ▶ mail Attachment B—Request for Comment Form—
along with written comments
- ▶ mail written comments
- ▶ e-mail written comments to *pubcom@nasd.com*
- ▶ submit written comments online on our Web Site
(*www.nasd.com*)

This form and/or written comments should be mailed to:

Barbara Z. Sweeney
NASD, Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Proposed Amendments to Rule 3010(g)(2) - "Branch Office" Definition

1. Should NASD adopt the proposed uniform branch office definition?
 Yes No See my attached written comments

2. Should NASD provide for the centralized registration of branch offices for NASD and other regulators through the CRD system?
 Yes No See my attached written comments

3. Are the exceptions to branch office definition appropriate?
 Yes No See my attached written comments

4. How many registered branch offices do you currently have?

5. How many registered branch offices would you have under the proposed uniform definition?

6. In how many states do you register branch offices?

7. a. How much of a cost savings or increase will you have as a result of the proposed uniform definition?
\$ _____

- b. If you expect the proposed definition would increase your costs, then would the efficiencies created by the ability to register branch offices through CRD offset such increased costs?
 Yes No See my attached written comments

Contact Information

Name: _____

Firm: _____

Address: _____

City/State/Zip: _____

Phone: _____

E-Mail: _____

Are you:

An NASD Member

An Investor

A Registered Representative

Other: _____