

fully compliant with Commission Rule 11Ac1–1 under the Act.<sup>8</sup>

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

The ISE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

The ISE has not solicited, and does not intend to solicit, comments on this proposed rule change. The ISE has not received any unsolicited written comments from members or other interested parties.

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

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

- (a) by order approve such proposed rule change; or
- (b) institute proceedings to determine whether the proposed rule change should be disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments may also be submitted electronically at the following e-mail address: *rule-comments@sec.gov*. All comment letters should refer to File No. SR–ISE–2003–34. This file number should be included on the subject line if e-mail is used. To help the Commission process and review comments more efficiently, your comments should be sent in hardcopy or by e-mail but not by both methods.

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the

Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the ISE. All submissions should refer to File No. SR–ISE–2003–34 and should be submitted by January 6, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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**BILLING CODE 8010–01–P**

this notice to solicit comments on the proposed rule change, as amended, from interested persons.

#### **I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

NASD filed the proposed rule change with the Commission (1) to amend NASD Rule 3010(g)(2) to revise the definition of the term “branch office”; and (2) to adopt IM–3010–1 to provide guidance on factors to be considered by a member firm in conducting internal inspections of offices. NASD represents that the purpose of the proposed rule change is to facilitate the creation of a branch office registration system through the Central Registration Depository (“CRD”)<sup>®</sup> to provide a more efficient, centralized method for members and associated persons to register branch office locations as required by the rules and regulations of states and self-regulatory organizations, including NASD. NASD expects centralized registration of such locations would provide efficiency, clarity, and costs savings to members. NASD believes that the creation of a uniform registration system for branch offices through CRD<sup>®</sup> also would allow NASD and other securities regulators to effectively examine such locations to further investor protections.

In addition, NASD represents that the proposed rule change is part of NASD's rule modernization initiative to streamline and update NASD Rules while preserving investor protections. The proposed definition establishes a broader national standard and is the product of a coordinated effort among regulators to reduce inconsistencies in the definitions used by the Commission, NASD, the NYSE, and state securities regulators in identifying locations where broker/dealers conduct securities or investment banking business. The proposed rule change is set forth below. Proposed new language is in *italics*; proposed deletions are in [brackets].

\* \* \* \* \*

#### **3000. Responsibilites Relating to Associated Persons, Employees, and Others' Employees**

#### **3010. Supervision**

- (a) through (f) No change.

subparagraph (g)(2)(C) of Rule 3010; and (iii) to correct punctuation in subparagraph (g)(3) of Rule 3010. In addition, in Amendment No. 2, NASD revised the discussion of the purpose of the proposed rule change (i) to remove a discussion regarding the Economic Advisory Board and references thereto, and (ii) to clarify a statement regarding the “branch office” definition proposed by The New York Stock Exchange (the “NYSE”) and its position with respect to such definition.

<sup>8</sup> 17 CFR 200.30–3(a)(12).

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

<sup>2</sup> 17 CFR 240.19b–4.

<sup>3</sup> 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”). In Amendment No. 1, NASD restated the proposed rule change in its entirety.

<sup>4</sup> 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”). In Amendment No. 2, NASD revised the proposed rule change (i) to insert the word “associated” into subparagraph (g)(2)(B)(i) of Rule 3010; (ii) to correct a cross-reference in

## (g) Definitions

(1) No Change.

(2) [“Branch Office” means 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, excluding:]

[(A) any location identified in a telephone directory line listing or on a business card or letterhead, which listing, card, or letterhead also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch locations are directly supervised;]

[(B) any location referred to in a member advertisement, as this term is defined in Rule 2210, by its local telephone number and/or local post office box provided that such reference may not contain the address of the non-branch location and, further, that such reference also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch location are directly supervised; or]

[(C) any location identified by address in a member’s sales literature, as this term is defined in Rule 2210, provided that the sales literature also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch locations are directly supervised.]

[(D) any location where a person conducts business on behalf of the member occasionally and exclusively by appointment for the convenience of customers, so long as each customer is provided with the address and telephone number of the branch office or OSJ of the firm from which the person conducting business at the non-branch location is directly supervised.]

A “branch office” is any location 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) 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;

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

(iii) Neither customer funds nor securities are handled at that location;

(iv) 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;

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

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

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

(viii) Written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member; and

(ix) A list of the residence locations are maintained by the member;

(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)(ii) through (viii) 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 an office;\*

(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 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; 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 in Rule 3010(g)(2) 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.

[(3) A member may substitute a central office address and telephone number for the supervisory branch office or OSJ locations referred to in paragraph (g)(2) above provided it can demonstrate to the Association’s District Office having jurisdiction over the member that it has in place a significant and geographically dispersed supervisory system appropriate to its business and that any investor complaint received at the central site is provided to and resolved in conjunction with the office or offices with responsibility over the non-branch business location involved in the complaint.]

## 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

\* 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 NASD, other self-regulatory organizations, and securities or banking regulators may be displayed and shall not be deemed “holding out” for purposes of this section.

*may need to provide for more frequent reviews of certain locations.*

\* \* \* \* \*

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

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

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

#### 1. Purpose

##### Background

While NASD believes that its current branch office definition effectively meets its regulatory objectives, NASD appreciates that a uniform branch office definition would create a broader national standard that would minimize compliance burdens for members. Adoption of the proposed branch office definition by NASD and state securities administrators would facilitate the creation of a centralized branch office registration system through the CRD®, and provide efficiency, clarity, and costs savings to members.

Currently, there is no uniform approach among regulators for classifying locations from which registered representatives regularly conduct the business of effecting transactions in securities. The Commission, the NYSE, and state securities regulators all define the term "branch office" (or similar term) differently; and the term has different significance based on who classifies it. 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.

NASD member firms are currently required to complete Schedule E to the Form BD ("Schedule E") to register or report branch offices to the Commission, NASD, and with particular state(s) in which they conduct a securities

business that requires branch office registration. While Schedule E does capture certain data with respect to branch offices, NASD represents that both its staff and state regulators believe that Schedule E does not adequately fulfill their regulatory needs. For example, Schedule E does not link an individual registered representative with a particular branch office; this can make it difficult for state regulators to track down individual persons during examinations. In addition, member firms have said that Schedule E is a burdensome and time-consuming method by which to register branch offices. Since numerous states have varying branch office definitions, members must understand and comply with the requirements in each individual state. Further, updates or amendments to Schedule E do not update or amend an individual registered representative's Form U-4. Currently, a firm must amend these forms separately and there is no method to alert firms or regulators if the information on the two forms differs. NASD believes that the proposed branch office registration system through CRD® would alleviate most, if not all, of these concerns.

As a result, NASD has been working with the North American Securities Administrators Association ("NASAA"), and the NYSE to reduce the inconsistencies that currently exist among the various ways in which locations are defined in order to increase the utility of CRD® as a central branch office registration system for NASD, other self-regulatory organizations, and states. NASD staff has held numerous meetings with other regulators over the past three years with the purpose of achieving this goal. NASD represents that these meetings ultimately proved successful as the parties have reached agreement on a core proposed uniform definition which largely tracks the Commission's definition of "office" in the books and records rules, Rule 17a-3 and Rule 17a-4 (the "Books and Records Rules") under the Act.<sup>5</sup>

The proposed definition would contain several exceptions from branch office registration. The single difference to a common definition among regulators concerns the registration of certain primary residences as branch offices. NASD and NASAA support a primary residence exception that provides for limitations on the activities (e.g., no holding out of the residence as a place to conduct securities business, and no handling of funds or securities

at the location), that can be performed at a primary residence without triggering branch office registration. The NYSE, however, believes that under no circumstances should associated persons be permitted to engage in securities activities for more than 50 business days annually from their primary residences without requiring members to register such residences as branch offices.<sup>6</sup>

##### Current Definition

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 definition provides that the following activities would not be deemed "holding out" and, therefore, would 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. NASD designates 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. 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. NASD represents that an office that is designated an OSJ must have a registered principal on-site and be inspected on an annual basis.<sup>7</sup>

##### Proposed Uniform Branch Office Definition

The core definition in the proposed uniform definition largely tracks the

<sup>5</sup> See Securities Exchange Act Release No. 46888 (November 22, 2002), 67 FR 72257 (December 4, 2002) (SR-NYSE-2002-34).

<sup>6</sup> 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.

Commission's Books and Records Rules' definition of "office."<sup>8</sup> The proposed rule change does not alter or affect the obligations of a firm to comply with the minimum requirements of the Books and Records Rules which specifies the records broker/dealers must make, and how long those records and other documents relating to a broker/dealer's business must be kept.<sup>9</sup>

The proposed rule change would define a "branch office" as any location 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 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 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 understands 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 proposed exceptions from branch office registration are practically based while still containing important safeguards and limitations to protect investors. For example, the exception from branch office registration for customer service/back office locations would require that no sales activities would be able to be conducted from such locations and such locations would not be able to be held out to the public.

Further, the primary residence exception contains significant safeguards, including that: the location cannot be held out to the public; 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; the associated person does not meet with customers at the location; neither customer funds nor securities are handled at that location; the associated person must be assigned to a designated branch office; and such branch office is used on all business cards, stationery, advertisements, and other communications to the public; the associated person's correspondence and communications with the public are subject to the firm's supervision; electronic communications are made through the firm's system; all orders are entered through the designated branch office or an electronic system established by the member and reviewable at such location; written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member; and the member maintains a list of the locations. These limitations closely track the limitations on the use of a private residence in the Commission's Books and Records Rules which provide that a broker/dealer is not required to maintain records at an office that is a private residence if only one associated person (or multiple associated persons if members of the same family) regularly conducts business at the office, the office is not held out to the public as an office, and neither customer funds nor securities are handled at the office.<sup>10</sup>

As noted above, in addition to these limitations on the primary residence exception, the NYSE believes that if an associated person works primarily from home, such location should be registered as a branch office.<sup>11</sup> Given the different business models used by NASD members that are not also NYSE members, 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. NASD represents that NASAA representatives have committed to recommending to their members (state securities regulators) adoption of the proposed branch office definition outlined in this rule filing (thus omitting the 50-business day limitation).<sup>12</sup>

NASD reached its conclusions as to the significant negative impact of the 50-business day requirement on members, without any added corresponding regulatory benefit or investor protection, after considering comments received in response to NASD Notice to Members 02-52. As discussed below, numerous firms asserted that the 50-business day requirement in the primary residence exception to the branch office definition would be burdensome, time consuming, and difficult to enforce. NASD concluded that limited member compliance resources could be more effectively directed to supervising activities at all locations, rather than tracking the number of days and hours an associated person works from his or her primary residence. NASD strongly believes that the numerous other safeguards that would need to be satisfied to qualify for the primary residence exception serve its regulatory needs and protect investors.

The 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.<sup>13</sup> 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.

In exempting offices of convenience from branch office registration, NASD believes that it again has imposed important safeguards for the public. At such offices of convenience, associated persons would be limited to meeting customers occasionally and exclusively by appointment, and the location would not be permitted to be held out to the public as a branch office. The proposed rule notes, however, that 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 NASD, other self-regulatory organizations, and securities or banking regulators would

<sup>8</sup> 17 CFR 240.17a-4(k).

<sup>9</sup> See NYSE Response to Comments to File No. SR-NYSE-2002-34, dated March 27, 2003.

<sup>10</sup> Letter dated April 17, 2003, from Christine A. Bruenn, NASAA President, to Marc Menchel, Senior Vice President and General Counsel, Regulatory Policy and Oversight, NASD. NASAA has stated that it supports the proposed uniform definition of "branch office" proposed herein and has stated that it will encourage its members (state

securities administrators) to adopt the proposed uniform definition.

<sup>11</sup> For purposes of satisfying condition (a) to the temporary location exception, an associated person would be deemed to "reside" at such temporary location.

be able to be displayed and would not be deemed "holding out" for purposes of this section. Such necessary signage generally is intended to prevent confusing customers who might otherwise believe that traditional riskless 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 locations 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.

#### **Proposed IM-3010-1 (Standards for Reasonable Review)**

Certain state securities regulators have expressed concern about their ability to cite members for violating the inspection and review standards set forth in NASD Rule 3010(c) where a registered person operates from his or her primary residence. They asked NASD staff to review the requirements of Rule 3010(c) and consider clarifying the standards.

NASD staff believes that Rule 3010(c) is an industry benchmark, imposing high standards regarding supervisory obligations and, therefore, should not be amended. As an alternative to amending Rule 3010(c), NASD is proposing new interpretive material, IM-3010-1 (Standards for Reasonable Review). Proposed IM-3010-1 emphasizes the requirement that members already have to 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 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.<sup>14</sup> 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 represents that the proposed interpretive material incorporates guidance previously issued on this matter by NASD.

#### **Development of Branch Office Registration System Through CRD®**

NASD operates the CRD® system pursuant to policies developed jointly with NASAA. NASD works with the Commission, NASAA, other members of the regulatory community, and member firms to establish policies and procedures reasonably designed to ensure that information submitted to and maintained on the CRD® system is accurate and complete. Currently, members with numerous offices must register with each individual state that requires registration (including annual renewals). Failure of members to timely register offices with a specific jurisdiction can result in significant sanctions; for example, in at least one jurisdiction, failure to timely register (or renew registration) can result in the possible rescission of all trades originated at that location. A uniform branch office definition would establish a broader national standard that would facilitate the development of a branch office registration system through the CRD®. NASD believes this approach would provide efficiency, clarity and cost savings to members and aid securities regulators in conducting regular examinations of such locations to further investor protections. NASD represents that members have strongly supported the use of CRD® to register branch offices because of the enormous potential time and liability savings.<sup>15</sup>

As part of the initiative, NASD expects to seek Commission approval to amend Form U-4 to require members to disclose, but not register, all non-branch

<sup>14</sup> NASD has filed a proposed rule change with Commission that seeks to adopt new Rule 3012 and amend other rules regarding the supervisory and supervisory control procedures of member firms. As part of such rule filing, Rule 3010(a) would be amended to provide that members must inspect (i) at least annually every office of supervisory jurisdiction and any branch office that supervises one or more branch locations; (ii) at least every three years every branch office that does not supervise one or more non-branch locations; and (iii) on a regular periodic schedule every non-branch location. The rule filing is pending. See Securities Exchange Act Release No. 48298 (August 7, 2003), 68 FR 48421 (August 13, 2003) (SR-NASD-2002-162).

<sup>15</sup> See Item 5 below for a summary of comment letters received in response to Notice to Members 02-52 (August 2002).

locations.<sup>16</sup> Further, NASD expects that the system would include a requirement that a branch office list any other names ("doing business as" or "DBAs") under which it may operate.

NASD expects to develop a new branch office registration form to collect data on each branch office. The new form also would require members to designate registered representatives to specific branch offices. NASD staff expects the system would include certain efficiencies; for example, when a member enters amendments to Form U-4, the system would automatically update corresponding items on the proposed new branch office registration form and vice versa.

NASD believes that it would take up to one year to develop a centralized registration system for branch offices and expects to have the system live by mid-2004.

#### **2. Statutory Basis**

NASD believes that the proposed rule change, as amended, is consistent with the provisions of Section 15A of the Act,<sup>17</sup> in general, and with Section 15A(b)(6) of the Act,<sup>18</sup> in particular, which requires, among other things, that NASD's rules must 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. NASD believes that a uniform definition would better serve the securities industry, regulators, and the public by creating a broader national standard that would allow for central registration of branch offices with NASD through the CRD® system. In addition, NASD represents that the proposed new interpretive material summarizes guidance previously issued on this matter by NASD.

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

NASD does not believe that the proposed rule change, as amended, would result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

A version of the proposed rule change, which included the 50-business day requirement in the primary

<sup>16</sup> NASD staff is working with NASAA to identify the level of activities that would trigger this reporting requirement.

<sup>17</sup> 15 U.S.C. 78o-3.

<sup>18</sup> 15 U.S.C. 78o-3(b)(6).

residence exception, was published for comment in NASD Notice to Members 02–52 (August 2002) (“NtM 02–52”). The text of the proposed rule change is available at the principal office of NASD, and at the Commission. NASD sought comment on whether the proposed uniform definition would: (1) Provide clarity on when a location is required to be registered as a branch office; (2) provide a cost savings to firms as a result of centralized registration of locations through the CRD® system; (3) minimize regulatory compliance burdens; (4) significantly affect the number of locations that a firm is required to register; and (5) adequately address evolving business practices based on technological innovations. Additionally, NASD sought comment on whether the proposed exceptions to the branch office were appropriate.

NtM 02–52 provided members and other interested parties with a checklist of seven questions that they could use to respond to the request for comment in addition to, or in lieu of, sending written comments. NASD noted that the checklist did not cover all aspects of the proposal, and it encouraged commenters to provide written comments, as necessary. NASD extended the comment period from September 20, 2002 to October 21, 2002 and received a total of 137 comments in response to NtM 02–52. A list of commenters and copies of the comment letters received in response to NtM 02–52 is available at the principal office of NASD, and at the Commission.

NASD represents that seventy-eight of the 137 responses to NtM 02–52 consisted solely of written comments (*i.e.*, did not complete the checklist of seven questions provided). The remaining 59 commenters responded to the checklist either in whole or in part. A significant percentage of the commenters identified themselves as member firms or registered representatives associated with NASD member firms. NASD represents that an overwhelming number of the commenters favored the creation of a uniform definition of the term “branch office” that would permit centralized registration of locations through CRD®. NASD has summarized the key comments below.

An overwhelming majority of the commenters were in favor of NASD providing centralized registration of branch offices through the CRD® system.<sup>19</sup> Commenters stated that a

uniform definition of branch office would greatly simplify their compliance obligations and that a uniform method of registering locations through CRD® would be welcome.<sup>20</sup> One commenter said that the current environment in which they are required to track numerous state definitions of “branch office,” fill out different forms to register locations as branch offices, comply with varying supervisory requirements for such offices and spend significant amounts of administrative time and energy complying is a very frustrating process and that the present situation is in dire need of immediate change.<sup>21</sup> However, numerous commenters expressed concern that a central registration system, while an improvement, could be too costly.

Commenters expressed concern about the impact of the proposed definition on the supervisory systems of their firms and related registration costs.<sup>22</sup> Commenters stated that the proposed definition would significantly increase registration fees and supervisory obligations of members.<sup>23</sup> Several commenters stated that the proposed definition would cause offices currently registered as branch offices to become OSJs since NASD Rule 3010(g)(1)(G) defines an OSJ as any office that supervises the activities of persons

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comment letter, dated September 13, 2002; B. Riley & Co. comment letter, dated September 10, 2002; BB&T Investment Services, Inc. comment letter, dated September 18, 2002; Carillon Investments, Inc. comment letter, dated September 16, 2002; Empire Securities Corporation of Southern California comment letter, dated September 17, 2002; GWR Investments, Inc. comment letter, dated October 25, 2002; Investment Centers of America, Inc. comment letter, dated August 30, 2002; Lesko Securities, Inc. comment letter, dated September 18, 2002; Packerland Brokerage Services, Inc. comment letter, dated September 9, 2002; Paradigm Equities, Inc. comment letter, dated October 18, 2002; Presidio Financial Services, Inc. comment letter, dated October 3, 2002; Private Portfolio, Inc. comment letter, dated August 22, 2002; Raike Financial Group, Inc. comment letter, dated September 9, 2002; Securian Financial Services, Inc. comment letter, dated September 6, 2002; and Triad Advisors, Inc. comment letter, dated September 20, 2002.

<sup>20</sup> See, e.g., Associated Securities Corp. comment letter dated September 13, 2002; Horace Mann Investors, Inc. comment letter, dated September 20, 2002; Securian Financial Services, Inc. comment letter, dated September 6, 2002; and T. Rowe Price Investment Securities, Inc. comment letter, dated September 19, 2002.

<sup>21</sup> See The O.N. Equity Sales Company comment letter, dated October 21, 2002.

<sup>22</sup> See, e.g., Mission Securities comment letter, dated September 17, 2002; and Oak Tree Securities comment letter, dated September 20, 2002.

<sup>23</sup> See, e.g., Lesko Securities, Inc. comment letter, dated September 18, 2002; National Planning Holdings, Inc. comment letter, dated September 3, 2002; National Association of Independent Broker/Dealers comment letter, dated September 7, 2002; and Transamerica Financial Advisors comment letter, dated September 16, 2002.

associated with other branch offices. Supervisors at these new OSJs would have to become registered principals.<sup>24</sup> Other commenters noted that smaller offices in smaller communities may elect to shut down their securities business and restrict themselves to related fields in which they may now be involved, such as insurance and tax preparation—this would mean less access to the financial system for people in these communities.<sup>25</sup>

In addition, commenters were concerned that the proposed definition would significantly increase the number of branch offices they would have to register. Commenters stated that they have between 0 and 225 branch offices currently registered but could have between 0 and 3,400 registered branch offices under the proposed uniform definition (based on a proposed definition that includes a 50-business day restriction in the primary residence exception). One commenter stated that with such definition, the firm would go from 1 to 700 registered branch offices.<sup>26</sup> A second commenter stated that they would go from 658 registered branch offices to over 1,000 registered branch offices if the proposed definition is applied to its unregistered offices and residential offices.<sup>27</sup>

Several commenters stated that any costs savings resulting from centralized registration of branch offices through CRD® would be greatly outweighed by the substantial increases in costs caused by having to register hundreds of remote locations as branch offices.<sup>28</sup>

Commenters generally were concerned that the proposed branch office definition (including the 50-business day limitation in the primary residence exception) would greatly increase their costs. These increased costs would include NASD and state registration fees, state corporation income tax filings, Fidelity bond coverage premiums, personnel time and travel expenses for inspections, and the hiring of more staff for supervision. A few commenters offered cost increase estimates ranging from \$3,000 to \$450,000 and elaborated on the reasons

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<sup>24</sup> See, e.g., Granite Securities, LLC comment letter, dated September 20, 2002; Equity Services, Inc. comment letter, dated September 19, 2002; and Lincoln Financial Advisors, Corp. comment letter, dated October 17, 2002.

<sup>25</sup> See, e.g., AM&M Investment Brokers comment letter, dated September 23, 2002.

<sup>26</sup> See Horace Mann Investors, Inc. comment letter, dated September 20, 2002.

<sup>27</sup> See Lincoln Financial Services, Inc. comment letter, dated October 17, 2002.

<sup>28</sup> See, e.g., Transamerica Financial Advisors comment letter, dated September 16, 2002; and Horace Mann Investors, Inc. comment letter, dated September 20, 2002.

<sup>19</sup> See, e.g., Allmerica Financial comment letter, dated August 28, 2002; Assist Investment Management Co., Inc. comment letter, dated October 18, 2002; Anderson LeNeave & Co.

for such increases.<sup>29</sup> Several commenters said that they could not accurately gauge cost increases until they know how states will amend their definitions. Several commenters suggested that NASD consider reducing its registration fees so that the rule change is revenue neutral for NASD and the financial burden on firms is minimized.<sup>30</sup> Commenters stated that they would realize certain cost efficiencies through centralized registration, provided the states also adopted the proposed definition.<sup>31</sup> NASD believes that the removal of the 50-business day requirement from the primary residence exception would alleviate some of the burdens that the original proposal raised regarding members' supervisory systems.

As noted earlier, the proposed definition as set forth in NtM 02-52 provided an exception from branch office registration for a primary residence that is used for securities business for less than 50-business days in any one calendar year and that satisfies, among other things, conditions similar to those found in the Commission's Books and Records Rules definition for "office." An overwhelming majority of the commenters stated that they could not support the proposed definition with a 50-business day requirement because it would be too burdensome, time consuming, and difficult to enforce.<sup>32</sup> Commenters argued that no added investor protection would be gained for this restriction.<sup>33</sup> Commenters stated that branch office registration should be based on the types of activities conducted at a location and not based on the number of days logged at a given

<sup>29</sup> See, e.g., Signator Investors, Inc. comment letter, dated October 16, 2002; and Granite Securities, LLC comment letter, dated September 20, 2002.

<sup>30</sup> See, e.g., Equity Services, Inc. comment letter, dated September 19, 2002; 1st Global Securities, Inc. comment letter, dated September 4, 2002; Moloney Securities Co., Inc. comment letter, dated October 19, 2002; Safeco Investment Services, Inc. comment letter, dated October 11, 2002; State Farm Insurance Companies comment letter, dated October 18, 2002; Sunset Financial Services comment letter, dated October 21, 2002; and The O.N. Equity Sales Company comment letter, dated October 15, 2002.

<sup>31</sup> See, e.g., The O.N. Equity Sales Company comment letter, dated October 15, 2002; and Metropolitan Life Insurance Company comment letter, dated September 30, 2002.

<sup>32</sup> See, e.g., Empire Securities Corporation of Southern California comment letter, dated September 17, 2002; INVEST Financial Corporation comment letter, dated September 4, 2002; and Securian Financial Services, Inc. comment letter, dated September 6, 2002.

<sup>33</sup> See, e.g., Securities Industry Association comment letter, dated October 21, 2002; and International Money Management Group, Inc. comment letter, dated September 26, 2002.

location.<sup>34</sup> In addition, several commenters stated that they view the proposal to be unenforceable because just as firms are unable to track the number of times representatives are involved in securities transactions for their clients from a certain location, NASD will similarly be unable to track such usage.<sup>35</sup>

Commenters, small firms in particular, stated that tracking the 50-business day requirement would introduce a tremendous compliance burden.<sup>36</sup> Commenters said the 50-business day limitation would require firms to closely monitor where work has been performed and for how long, and such monitoring would be prone to error. Commenters stated that the proposed definition provides sufficient restrictions on the use of a primary residence office and, so long as the activities are substantially limited (e.g., no holding out of the residence as a place to conduct securities business, and no handling of funds or securities at the location) and the location is properly supervised, the number of days logged at such residential location should not trigger registration of such location as a branch office.<sup>37</sup> Commenters also stated that the resulting increase in supervisory costs would cause firms to act contrary to all employment trends by prohibiting people from working outside the office.

Commenters also noted that elimination of the 50-business day restriction would be consistent with the Books and Records Rules. They asserted that since the Books and Records Rules do not require records to be kept at these sites for examinations, there should be no reason to register a representative's primary residence regardless of the number of days it is used for securities business, provided the other conditions to the exception are satisfied.<sup>38</sup>

Based on the comments to NtM 02-52, NASD is proposing to retain the definition described in NtM 02-52, without the 50-business day restriction contained in the primary residence

<sup>34</sup> See, e.g., AM&M Investment Brokers comment letter, dated September 23, 2002.

<sup>35</sup> See Keystone Capital Corporation comment letter, dated September 7, 2002; and XCU Capital Corporation comment letter, dated September 16, 2002.

<sup>36</sup> See, e.g., Pashley Financial comment letter, dated September 23, 2002; and Vasilou & Company, Inc. comment letter, dated October 1, 2002.

<sup>37</sup> See, e.g., GWR Investments, Inc. comment letter, dated October 25, 2002; and A.G. Edwards, Inc. comment letter, dated October 11, 2002.

<sup>38</sup> See, e.g., Securian Financial Services, Inc. comment letter, dated September 6, 2002; and A.G. Edwards & Sons, Inc. comment letter, dated October 11, 2002.

exception. The elimination of the 50-business day requirement contained in the primary residence exception should mitigate the additional registration and supervisory burdens on firms that would result from the proposed rule change. In addition, NASD believes these modifications would not disrupt the business model used by many NASD member firms.

Commenters also expressed concern that the temporary location exception in the proposed definition is too restrictive. The proposed definition provides an exception from branch office registration for a location, other than a primary residence, that is used for securities business less than 30 business days in any one calendar year and that satisfies the other conditions set forth in the primary residence exception. Certain commenters asked that the 30-business day limitation be eliminated for many of the same reasons described above with respect to the 50-business day requirement in the primary residence exception. NASD, however, believes that limiting the number of days such location can be used is consistent with the intent of this exception. The exception from registration is for a temporary location, as opposed to a primary residence, and a bright-line test of what constitutes "temporary" is intended to make the application of this exception consistent.

Commenters also sought clarification as to the application of the office of convenience exception. The proposed definition provides an exception from branch office registration for any office of convenience, where associated persons occasionally and exclusively by appointment meet with customers, and that is not held out to the public. Commenters sought clarification on whether this exception applies to associated persons generally or is limited strictly to bank circuit riders.<sup>39</sup> In numerous discussions with members and others, NASD has made clear that this exception is applicable to all members that satisfy the conditions, not just bank circuit riders.

Commenters also raised concerns about the non-securities business location exception. The proposed definition provides an exception from branch office registration for 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 so long as the address/phone number of the supervising office is set forth on all

<sup>39</sup> See, e.g., BB&T Investment Services, Inc. comment letter, dated September 18, 2002.

advertisements. Commenters said that the non-securities business exception, which limits securities activities to no more than 25 securities transactions annually, is vague and that the threshold number is too low.<sup>40</sup> Commenters asked that the number of securities transactions allowed in any one-year be increased, or that certain systematic (automatic) payments not count towards the 25 securities transactions limit.<sup>41</sup> In this regard, NASD intends to provide interpretive guidance to members on a case-by-case basis regarding specific application of the exception.

Commenters also stated that the proposed rule is not in step with the prevalent use of modern communications technology to effect transactions from remote locations because it continues to use a "bricks and mortar" approach to the definition.<sup>42</sup> Commenters stated that modern communications technology, such as mobile telephones, laptop computers, and personal digital assistants (PDAs), is diminishing the need for branch offices to be in a physical location. With such technology, registered representative can effect transactions anywhere. These commenters asserted that consumers and investors now accept such means of conducting business and the proposed definition is outdated.<sup>43</sup> Several commenters also stated that the proposal, which would require the listing of branch office locations, including primary residences, might invade the privacy of registered representatives. The commenters stated that addresses of primary residence offices should not be made publicly available.<sup>44</sup>

Based on the comments to NtM 02-52, NASD is proposing changes to the original proposal as described above. NASD believes that these modifications would address a majority of concerns raised by commenters to the original proposal. Overall, NASD believes that the proposed definition would establish

<sup>40</sup> See, e.g., Northwestern Mutual Investment Services, LLC comment letter, dated September 20, 2002; and Carillon Investments, Inc. comment letter, dated September 16, 2002.

<sup>41</sup> See, e.g., Equity Services, Inc. comment letter, dated September 19, 2002.

<sup>42</sup> See, e.g., Associated Securities Corporation comment letter, dated September 13, 2002.

<sup>43</sup> See, e.g., Lincoln Financial Advisors comment letter, dated October 17, 2002; and Source Capital Group comment letter, dated September 19, 2002.

<sup>44</sup> See, e.g., Keystone Capital Corporation comment letter, dated September 7, 2002; Mission Securities Corporation comment letter, dated September 17, 2002; and West America Securities Corp. comment letter, dated September 17, 2002; and National Planning Holdings, Inc. comment letter, dated September 3, 2002.

a broader national standard for classifying such locations and would provide administrative and cost efficiencies to members through the creation of a centralized registration system on CRD®. In addition, NASD believes that the proposed rule change would allow regulators to effectively monitor and audit locations and the activities conducted there without compromising investor protection. Each exception to the proposed branch office definition contains important safeguards and limitations. In particular, the primary residence exception contains the same safeguards provided in the Commission's Books and Records Rules exception for private residences (which also does not contain any restrictions on the number of business days an associated person may operate from his or her residence). NASD determined to remove the 50-business day requirement from the primary residence exception because NASD believes it does not serve any added regulatory benefit and, instead, imposes substantial costs and burdens to the industry. Based on the extensive comments from the industry, NASD, on balance, does not believe that the costs of such provision outweigh the benefits.

NASD would announce the effective date of the proposed definition of the term "branch office" in a Notice to Members. NASD expects the effective date of the proposed rule change would correspond with the commencement date of the centralized branch office registration system on CRD®.

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

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

- A. By order approve such proposed rule change, as amended, or
- B. Institute proceedings to determine whether the proposed rule change, as amended, should be disapproved.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. In particular, the Commission seeks commenters' specific views on the 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.

Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: *rule-comments@sec.gov*. All comment letters should refer to File No. SR-NASD-2003-104. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-2003-104 and should be submitted by January 6, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>45</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48887; File No. SR-NASD-2003-110]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 by the National Association of Securities Dealers, Inc. Relating to Uniform Hearing Procedures for and Consolidation of Rules Applicable to Expedited Proceedings

December 5, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934

<sup>45</sup> 17 CFR 200.30-3(a)(12).