

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

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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.⁵

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.⁶

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.⁷

Proposed Uniform Branch Office Definition

The core definition in the proposed uniform definition largely tracks the

⁶ See Securities Exchange Act Release No. 46888 (November 22, 2002), 67 FR 72257 (December 4, 2002) (SR-NYSE-2002-34).

⁷ 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.

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