



Securities Industry Association

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October 21, 2002

Ms. Barbara Z. Sweeney
Senior Vice President and Corporate Secretary
NASD
Office of the Corporate Secretary
1735 K Street, N.W.
Washington, D.C. 20006-1500

RE: NASD Notice to Members 02-52

Dear Ms. Sweeney:

The Securities Industry Association (SIA)¹ appreciates the opportunity to comment on NASD Notice to Members 02-52, which proposes amendments to NASD Rule 3010(g)(2) (Branch Office Definition) that are designed to achieve uniformity among the SROs and state regulators and consistency with the SEC's new books and records rules.²

SIA applauds NASD for initiating a process intended to reduce the regulatory burdens currently imposed upon firms.³ This is especially timely and appropriate given the current economic climate.

While SIA believes generally in such uniformity and/or consistency and shares the NASD's desire for a carefully constructed branch office definition, we believe the effort is complicated by the various implications the definition has under each set of SRO

¹ The Securities Industry Association brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In the year 2001, the industry generated \$198 billion in U.S. revenue and \$358 billion in global revenues. Securities firms employ approximately 750,000 individuals in the United States. (More information about SIA is available on its home page: <http://www.sia.com>.)

² As you note, "[t]he 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." NASD Notice to Members 02-52, Proposed Amendments to NASD Rule 3010(g)(2) ("Branch Office Definition"), August 2002, at 497.

³ NASD has on several occasions expressed its interest in ensuring "that NASD rules are as streamlined as possible, and impose the least burden to accomplish their objectives while achieving investor protection." *Id.* at 496.

rules. For example, one of our main concerns with this new definition is that it, among other things, challenges the current practice of allowing associated persons to work from home or other non-office locations. The proposed change would require substantial firm reorganization, including the creation of numerous new supervisory positions, at significant incremental cost with little or no incremental investor protection.

Nevertheless, uniformity does have its benefits and with some specific carve-outs, may in fact be desirable in connection with the definition of branch office. As you note in your Release, the fact that the NASD, Securities and Exchange Commission, NYSE and state regulators each have a different view of what constitutes a branch office imposes substantial costs on firms as they struggle to track the different definitions, satisfy the varying registration requirements, and seek to avoid non-compliance.⁴

SIA's specific concerns and recommendations are discussed below.

1. Branch Office registration should be determined by office function and not by the number of days logged at a given location.

Exclusion (B) of the proposed rule would seem to require firms to register the primary residences of associated persons as branch offices if the associated persons work from home fifty or more days a year. In determining what constitutes a branch office, SIA believes that the amount of time spent at a location is of little significance. What matters is the type of activities performed at a site, the records maintained, the number of registered representatives working there, the ability to conduct supervision, and how the location is held out to the public.

SIA believes that, if an associated person working from his or her primary residence has restrictions placed on the activities performed there, then the residence should not be a branch office regardless of the number of days that a person works there. For example, if an associated person does not hold his or her residence out to the public as an office for the purpose of conducting a securities business, does not handle funds or securities at the location, enters orders electronically or through the designated branch office, routes outgoing mail through the member's electronic network, and is subject to oversight and supervision from a designated branch office, then the location does not perform the same functions as a branch office and clearly should not be treated as such.

The same is true for one-man or two-man offices located at a business location. If the activities of these persons are substantially restricted and closely scrutinized to protect against improper conduct, we believe that such locations should not be placed in the same category as a branch office.

SIA believes that real investor protection comes from limiting the types of activities performed outside the branch office and providing appropriate supervision of all

⁴ *Id.* at 497. "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."

associated persons, regardless of where they are conducting their business. In addition, we are unaware of any pattern or particularly unique abuses in connection with associated persons who work regularly or fairly regularly from home. In light of these factors, we believe the 50-day cap on working from home and the 30-day cap on working at other locations is unnecessary, unduly cumbersome, and provides little value in terms of investor protection.

2. Registering associated persons' primary residences and other locations "used for securities business" creates numerous logistical difficulties.

As a separate but related matter, there are numerous logistical obstacles presented by the new definition. In today's electronic environment, it is not unusual in this industry as in many others to find individuals working outside the traditional business setting. Work can be done – and done well – in such varied places as an airplane, a hotel room, and many other non-office locations.

Imposition of the new definition of branch office would result in firms needlessly having to closely monitor where work was being performed and for how long. Some of the innumerable questions and different scenarios firms would be faced with include the following:

- Does an associated person sometimes work from home? If so, how many days a year and how many hours a day?
- Did the associated person work at the branch office for four or more hours before heading home? If so, his or her work from home needn't be counted.
- Do you register an associated person's primary residence as a branch office at the beginning of the year if he or she expects to spend fifty or more days a year working from home? What if they then don't actually hit the fifty-day mark? Conversely, do you wait until the fiftieth day has been triggered and then register?
- How should one treat temporary dislocations caused by unexpected family emergencies? It would seem time consuming and counterproductive to register these clearly temporary sites.
- What about associated persons who are semi-retired, on maternity leave or working from a non-business location for personal reasons?

Under this proposed rule, firms are faced with three equally unattractive outcomes. First, they can take the substantial time and effort to track each and every person's whereabouts and to register those locations that satisfy the 50-day threshold. Second, several member firms have already indicated that they will not go through the tracking process, but will instead register every associated person's residence as a branch office. This lessens their monitoring costs and assures that there are no gaps, but imposes

substantial supervisory costs, and makes the definition less meaningful to NASD and state regulators. Finally, SIA believes that some member firms will just prohibit people from working outside the office, which is not an attractive option because it is contrary to all employment trends.

The likelihood that firms will choose not to track but rather to register everybody or preclude all activity outside the branch is increased by the serious consequences for an inadvertent failure to register. Currently, failure to register a branch office in a state may provide a basis not only for regulatory action by a state regulator, but also for rescission or damages by plaintiff attorneys. The imposition of requirements for residences that are not held out as places of business to the public to be registered as branch offices if more than a certain amount of days or hours are spent at a site results in additional and unnecessary uncertainty and risks for inadvertent failure to register.

3. Registering primary residences and other locations used for securities businesses imposes substantial costs.

If the recently proposed definition is adopted, the number of registered branch offices will increase dramatically. This will result in substantially increased costs for large and small firms alike.

Perhaps the most significant and costly impact will be attributable to the related NASD requirement that an office with “responsibility” for supervising the activities of persons associated with the member at one or more other branch offices of the member be designated an “Office of Supervisory Jurisdiction” (OSJ).⁵ Since this new definition would result in the registration of vastly more branch offices for many firms, an increase in the number of OSJ’s will necessarily follow. This will result in added costs related to incremental licensing, additional compliance reviews, staffing at the branch offices to handle examinations and compliance with the SEC’s books and records rules, increased branch office registration fees for every individual working from home more than 50 days a year, and the cost of an increased blanket fidelity bond.

In 02-52’s Executive Summary, NASD specifically asks whether the proposed definition of branch office “provides a cost savings to firms as a result of centralized registration of locations through NASD’s CRD system.”⁶ Our membership is quite concerned that the registration, bonding, personnel, and supervisory costs associated with this proposed definition far outweigh any cost savings through centralized registration. We are also concerned that tracking, additional registrations and increased supervisory requirements may actually increase our regulatory burden.

⁵ See NASD Rule 3010(g)(1)(G).

⁶ NASD Notice to Members 02-52 at 495.

4. The 50 Day Limitation Raises Potential Inconsistencies with the SEC’s Books and Records Rules.

The Securities and Exchange Commission’s newly adopted Books and Records Rules make clear that records need not be kept at private residences, but can instead be maintained at another location within the same state. Rule 17a-4(k) states:

“If an office is a private residence where only one associated person . . . regularly conducts business, and it is not held out to the public as an office nor are funds or securities of any customer of the member, broker or dealer handled there, the member, broker or dealer need not maintain records at that office, but the records must be maintained at another location within the same State as the member, broker or dealer may select (emphasis added).”

The proposed NASD amendments state “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.”⁷ SIA is concerned that the mere act of registering a primary residence as a branch office under NASD Notice to Members 02-52 could be misinterpreted as satisfying the “holding out” requirement. We encourage NASD and/or the SEC to clarify that this is not the case.

5. The regulations should clarify that overseas locations do not require registration.

SIA would also like to clarify that the overseas locations where foreign associates conduct business would not be required to register as branch offices under this new definition. We believe that this is the only logical result.

For example, some firms treat foreign associates as dual employees. NASDR does not permit foreign associates to register as principals, yet this would be necessary under the new definition, which states that as non-registered offices become registered branch offices, persons supervising those offices have to register as principals at OSJs. In addition, there would be numerous other regulatory requirements that would be inadvertently triggered by registration of foreign locations as branches under NASD regulation. These regulatory requirements may be in direct conflict with local regulatory requirements applicable to the members’ office in an overseas location. For these reasons as well, firms that require overseas employees of affiliated U.S. broker-dealers to become associated persons of the U.S. broker-dealer should not be required to treat the respective locations of those persons as branch offices.

Given the unintended consequences of such action and the absence of any investor protection concerns motivating this definitional change, SIA respectfully requests that NASD should make clear that the branch office definition does not extend overseas.

⁷ *Id.* at 497.

Conclusion

In conclusion, SIA believes that investors are adequately protected by existing regulations and best practices which dictate that a primary residence or other non-office location does not have to be registered as a branch office if an associated person: (i) does not hold the location out to the public; (ii) does not meet clients there; (iii) does not accept or custody funds or securities there; (iv) maintains records in a registered location; (v) enters trades electronically or at a designated branch office; and, (vi) the firm maintains a list of all residence locations, which would be available to regulators as needed.

We would strongly encourage NASD not to require the registration of primary residences and other non-office locations as branch offices, in all but the most limited of circumstances. Specifically, branch office registration should only be required when the activities occurring at the site are truly those of a branch office location.

Please do not hesitate to contact me at 212-720-0611 should you have any questions.

Sincerely,

A handwritten signature in cursive script that reads "Kim Chamberlain".

Kimberly H. Chamberlain
Vice President and Counsel
State Government Affairs