

Uniform Definition of Branch Office Explained and Clarified In New NASD and NYSE Releases

By Paul B. Uhlenhop

I. INTRODUCTION

The NASD and NYSE have recently released a joint interpretation of the new uniform definition of "Branch Office" interpreting the exemptions from the term "Branch Office."¹ The effective date for the new uniform definition was postponed from May 1, 2006 until July 3, 2006. Although the NASD and NYSE notified members of the new uniform definition of "Branch Office" in October 2005,² the effective date was changed because the new interpretation clarifies the original ambiguous wording. The new interpretation in NTM 06-12 is very important because it clarifies the meaning of what is a "Branch Office" and interprets many of the exclusions from the term "Branch Office." The definition of "Branch Office" is interpreted in a pragmatic way, reducing the scope of some of the broad terms used in the definition of a branch. Members should carefully review NTM 06-12 because it is quite complex and certain offices may fall within the definition of "Branch Office." Importantly, some offices that were considered to be within its terms are excluded by the new guidance.

The uniform definition of "Branch Office" is a commendable attempt by the SEC, the NASD, the NYSE and the North American Securities Administrators Association (NASAA) to fashion a uniform branch office definition that could be used by all of the regulators. In addition, the uniform definition allowed for amendments of Forms U-4 and U-5, as well as CRD filing Form BR designating branch offices for all regulators (See NTM 05-66, October 2005). Without a uniform definition, the CRD network did not

function effectively, particularly with respect to state notifications of branch offices because states had disparate definitions. The uniform definition and the exclusions are a step forward. Unfortunately, the definitions were quite ambiguous as originally promulgated. However, NASD NTM 06-12 provides commendable clarity. The purpose of this article is to discuss the recent NTM 06-12.

II. FILED FORMS BR, U-4s and U-5s.

At the time of the adoption of the new uniform definition of "Branch Office" in October of 2005, the NASD and NYSE also adopted Form BR to notify the NASD, NYSE and states of branch offices through the CRD system. At the same time, changes were made to Forms U-4 and U-5 to include certain branch office information.³ Many firms have filed Form BR since the original compliance date was May 1, 2006, and amended individual Forms U-4 or U-5 in accordance with the broad scope original definition of "Branch Office." These forms may now be inaccurate by reason of the new interpretive positions taken in NTM 06-12. As a result, broker-dealers may need to amend Forms BR which have been filed and likewise change Forms U-4 and U-5 which are on file.

The new uniform definition of "Branch Office" in 3010(g)(2) and NYSE Rule 342.10 is as follows: "any location where one or more associated persons of a member regularly conducts the business of effecting any transaction in, or inducing or attempting to induce the purchase or sale of any security, *or* that is held out as such." (emphasis added)

This is somewhat similar to the prior definition. However, the prior definition was conjunctive in the sense that the office had to both be held out to the "public or customers as an office at a location from which the member

conducts an investment banking or securities business" subject to certain exclusions. The new definition is disjunctive, bringing in significantly more offices, including presumably proprietary trading locations and various other locations which are not held out to the public as offices where business was conducted. However, the new interpretative advice described below narrows the broad definition in Rule 3010(g)(2) and NYSE Rule 342.10.

III. EXCLUSIONS FROM THE NEW DEFINITION

The new uniform branch office definition excludes from registration as a "Branch Office" the following:

- (1) a non-sales location that provides customer service or back office functions;
- (2) an associated person's primary residence provided that it is not held out to the public as a branch office, and certain other conditions are satisfied;
- (3) a location, other than the primary residence, that is used for less than 30 business days in any calendar year for securities business, is not held out to the public as an office, and which satisfies certain of the conditions set forth in the primary residence exemption;
- (4) a location of convenience used occasionally and by appointment;
- (5) a location used primarily for non-securities business and from which no more than 25 securities transactions are effected annually;
- (6) the floor of a registered securities exchange; and
- (7) a temporary location used as part of a business continuity plan.⁴

IV. THE MEANING OF "REGULARLY CONDUCTS"

One of the vagaries in the uniform definition is the phrase "regularly conducts the business of effecting transactions." The NASD states that this

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phrase would include the following:

- (1) soliciting new accounts or orders;
- (2) opening new accounts;
- (3) accepting or executing orders; and
- (4) making recommendations with respect to securities transactions.⁵

Notwithstanding the above implying that accepting or executing orders would result in a branch, as explained below, an office conducting solely proprietary transactions is not a "Branch Office." Therefore, the above wording refers implicitly to *customer* orders and transactions, not proprietary order and transactions. (See Section VII below.)

V. NON-SALES AND BACK OFFICES

Non-sales or back offices are exempt functions which do not result in a branch office. The NASD NTM states that a non-branch office may not be held out to the public as a branch office and it must be engaged solely in customer service or back office activities. No sales activities may be conducted from such a location. Solely clerical and administrative activities may be conducted from a non-branch, non-sales location.⁶

VI. INVESTMENT BANKING OFFICES

Non-sales locations also include investment banking services, provided the only activity is to solicit clients for members' investment banking services. No other activities may be conducted at the location.⁷ The definition of investment banking services contained in NASD Rule 2711 and NYSE Rule 472.0 includes:

acting as an underwriter in an offering for the issuer, acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs (private investment, public equity transaction), or similar investments; or serving as placement agent for the issuer. The term also includes acting as a member of a selling group in a securities underwriting.

VII. PROPRIETARY TRADING AND SECURITIES TRADING OFFICES

In accordance with past no-action letters under the old definition of branch office, the NASD in its NTM 06-12 states specifically that an office that engages solely in proprietary trading or securities lending is considered a non-sales location provided that no other sales functions are conducted and the location is not held out to the public as a branch office.⁸

VIII. RESEARCH OFFICES

The NASD guidance states that a non-sales location includes an office where qualified supervisory analyst's (Series 16) sole activity is to generate research reports. However, the NASD points to NASD Rule 3010(g)(1) which provides that approving advertising or sales literature would make an office an Office of Supervisory Jurisdiction (OSJ) and require branch office status because all OSJs are branch offices. Thus, if a final approval of research material or other communication takes place at a specific office, the office is an OSJ requiring designation as a branch office.

IX. PRIMARY RESIDENCE EXEMPTION**A. In General**

The uniform definition exempts any location that is an associated person's primary residence provided the following:

- (a) only one associated person, or multiple associated persons who reside at the location and are members of the same immediate family, conduct business from the location;
- (b) the location is not held out to the public as an office and the associated person *does not meet with customers at* the location;
- (c) neither customer funds nor securities are handled at the location;
- (d) the associated person is assigned to a designated branch office, and such designated branch office is reflected on all business cards, stationery, advertisements, and other communications to the public by the associated person;
- (e) the associated person's

correspondence and communications with the public are subject to the member's supervision in accordance with NASD Rule 3010 and NYSE Rules 342 and 472;

- (f) electronic communications (*e.g.*, e-mail) are transmitted through the member's electronic system;
- (g) all orders are entered through the designated branch office or through an electronic system established by the member that is reviewable at the branch office;
- (h) written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member; and
- (i) a list of the residence locations is maintained by the member.⁹ (Emphasis Added.)

B. Address, Telephone Numbers and Cell Phone Numbers of Primary Residence

One of the conditions is that the associated person be assigned to a designated branch office and the *address* of such designated branch office must be on all business cards, stationery and communications to the public. The NASD states that this means the use of a primary residence address in such communications will be deemed holding out and would void the exemption, even if the communication sets forth the address and telephone number of the branch office or OSJ from which the associated person is supervised. However, the associated person may use the telephone number or the mobile telephone number of an unregistered location (such as a primary residence) in directories, but not the address of such location in directories, on business cards, stationery, advertisements and other communications with the public by such associated person. In summary, you cannot use the address of the primary residence, but you can use a telephone or cell phone number of the primary residence or other unregistered location provided the address and telephone numbers of the Branch are also included.¹⁰

C. Customer Funds and Securities
Customer securities or funds

may not be accepted or handled at a primary residence excluded location. However, an associated person may accept funds or securities at an "Office of Convenience" providing the funds are payable to the member or issuer as the case requires, the funds are not deposited by the associated person and the associated person promptly forwards all such funds and securities to the member or issuer as required. (See "Offices of Convenience" discussion which follows.) If such funds are received from a customer at an "Office of Convenience" and the funds or securities are brought to the primary residence location, it is not considered a violation of the primary residence exemption provided the funds and securities are promptly forwarded to the member or issuer.¹¹

D. Electronic Communications

The NASD emphasized in 06-12 that electronic communications must be through the member's electronic system, entered through the designated branch office or through an electronic system established by a member that is reviewable by the branch office. This means that primary residence personal e-mail accounts may not be used to communicate with potential or actual customers.¹²

X. TEMPORARY LOCATIONS

Any location other than the primary residence may be an exempt location provided that it is used for less than 30 business days in any calendar year. This is primarily designed to exclude vacation or secondary homes and other non-primary residences. These locations are subject to most of the criteria enumerated above imposed on exempted primary residences. Business day excludes any partial day provided the associated person spends at least 4 hours of the day at his or her designated branch office during the period that an office would normally be open for business. If the 30 day exemption is to be relied upon, there must be detailed records demonstrating compliance maintained by the member. It should be noted that a temporary use of an office as part of a business continuity plan

because of a disaster of some sort is not considered a violation.¹³

XI. OFFICES OF CONVENIENCE

A. In General

The definition exempts an "Office of Convenience" which is defined as a location "where an associated person *occasionally* and *exclusively* by appointment meets with customers provided the office is not held out to the public as an office."¹⁴

B. Bank Networking

In connection with bank networking arrangements where certain signages are necessary to comply with applicable federal and state law and rules and regulations, compliance with such rules and regulations will not be deemed holding out for purposes of the "Branch Office" definition. For example, if there are multiple offices bank circuit riders visit from time to time, the "Office of Convenience" exemption may be applicable, but the location may not be held out to the public. It is important to note that in any "Office of Convenience," the associated person may meet only *occasionally* and *exclusively* by appointment. The NASD explains that the associated person meeting at an "Office of Convenience" may not establish regular business hours at such location or hold it out in any way except for the permitted signage. For example, if there is a pre-determined schedule at a particular location, it would not qualify as an "Office of Convenience." Likewise, if the associated person meets with walk-in customers, such location would not qualify for exemption. For example, if an associated person meets regularly at a school to explain 403(b)-type offerings to teachers or other perspective participants, such location would not qualify for exemption. Surprisingly, the NASD states that at an "Office of Convenience," Internet access by customers may be allowed to their specific accounts, including allowing customers to enter orders through an order entry and execution system. There can be no publicly displayed signage on the computer terminals or other indicia of holding out. This latter point

may limit the utility of the NASD's exemption.¹⁵

XII. LOCATIONS USED PRIMARILY TO ENGAGE IN NON-SECURITIES ACTIVITIES, I.E., INSURANCE OFFICES, REAL ESTATE OFFICES AND SIMILAR LOCATIONS

The uniform definition exempts locations where associated persons are "*primarily*" engaged in non-securities activities like insurance or real estate. However, the exemption is limited severely by a provision that an associated person may effect no more than 25 securities transactions from such a location in a calendar year. The NASD excludes from the 25 securities transactions any automatic investment plans where the customer has given prior instructions to purchase a pre-determined number of shares on a regular basis provided an associated person makes no further recommendations concerning the investment plan or securities. Further, any communication such as advertisements or sales literature and business cards identifying the location must set forth the location from which the associated person is directly supervised. NTM 06-12 provides that if you exceed the 25 securities transactions in any calendar year, the office must be registered within 30 days.¹⁶

XIII. MISCELLANEOUS OFFICES

A. Call Centers

Any call center that can respond to customer questions and accept orders of the customer must be registered as a branch office even though no advice or recommendations is given.¹⁷

B. Main Offices

Main offices must be registered as branch offices if the activities at such office satisfy the definition of branch office.¹⁸ All OSJ offices are branch offices, including main office OSJs.

C. Offices of Supervisory Jurisdiction

Any office that supervises any other offices, including non-branch offices and any OSJ, must be registered as a branch office. It should be noted that this

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provision became effective on January 31 and a similar provision in NYSE 342.10 became effective September 9, 2005.¹⁹

D. Foreign Offices

Foreign offices must be registered if they meet the conditions of the definition of branch office unless they are otherwise exempt.²⁰

XIV. IMPACT OF NASD RULE 1017

Rule 1017 requires a member to submit an application for approval for an increase in the number of branch offices under certain specific requirements where (1) there is a material change in business as defined in NASD Rule 1011 and is not excluded by IM-1011-1 or (2) there is a membership agreement with the NASD to not expand or to not add additional branches without NASD approval. As a result of recent changes to Rule 3010, certain locations previously not considered branches may be considered branches and must be registered as such. However, such offices are grandfathered for purposes of Rule 1011 and Rule 1017. These branches will not be considered a material change or increase in the number of offices without changing the membership agreement.²¹

XV. AMENDING FORMS U-4 AND U5 AND FORM BR AS A RESULT OF THE RECENT INTERPRETATION OF NTM 06-12 AND NYSE INFORMATION MEMORANDUM

As a result of the clarifying interpretations with the definition of branch office and exclusions, members may need to amend their Forms BR and/or Forms U-4 or U-5 to include or exclude certain branch offices.


XVI. SUMMARY

All in all, the NASD, NYSE and NASA are to be applauded for developing a uniform definition which has long been needed. This will substantially assist filing branch offices notices by permitting the CRD system to handle such branch office notifications, particularly for

state purposes. In addition, the recent interpretation contained in NTM 06-12 provides needed clarity although there will obviously be some situations that are not covered. All in all, the new interpretations are important and should be read carefully by every member.

1. NASD NYSE Joint Interpretive Guidance; NASD Notice to Members 06-12 (March, 2006); NYSE Information Memo 06-14 (March 2006).
2. NASD Notice to Members 05-66 (October 2005); NYSE Information Memo 05-74 (Oct. 2005)
3. *Id.*
4. NTM 06-12, p. 3.
5. *Id.*, at 3.
6. *Id.*, at 4.
7. *Id.*, at 4.
8. *Id.*, at 4.
9. *Id.*, at 5.
10. *Id.*, at 6.
11. *Id.*, at 6.
12. *Id.*, at 6.
13. *Id.*, at 7.
14. *Id.*, at 7-8.
15. *Id.*, at 9.
16. *Id.*, at 9.
17. *Id.*, at 10.
18. *Id.*, at 10.
19. *Id.*, at 10.
20. *Id.*, at 10.
21. *Id.*, at 11.

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