

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52640; File No. SR-NYSE-2004-51]

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Notice of Filing of Proposed Rule and Amendment No. 1 Thereto Relating to a Proposed Interpretation to Rule 342 (Offices—Approval, Supervision, and Control)

October 19, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on September 3, 2004, the New York Stock Exchange, Inc. (“NYSE” or the “Exchange”) filed with the Securities and Exchange Commission (“SEC” or the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On September 28, 2005, the Exchange filed Amendment No. 1 to the proposed rule change, replacing the original filing in its entirety. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The NYSE is filing with the Commission a proposed Interpretation of Exchange Rule 342 (Offices—Approval, Supervision, and Control) to permit the waiver of the qualified resident branch office manager requirement for “limited purpose offices” with more than three registered representatives. The text of the proposed rule change is available on the NYSE Web site (http://www.nyse.com/pdfs/NYSE-2004-51_A-1.pdf), at the principal office of the NYSE, and in the Commission’s Public Reference Room.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change 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. The Exchange 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

Synopsis

The Exchange proposes amendments to NYSE Rule 342 that would permit members and member organizations to seek a waiver of the qualified (Series 9/10—General Sales Supervisor, Options/General or Series 24—General Securities Principal (after July 1, 2001) examinations) resident branch office manager requirement for “Limited Purpose Offices” with more than three registered representatives (“RRs”). “Limited Purpose Office” is a proposed new category that would include branch office locations with RRs that conduct limited business activities, or that have limited registration qualifications (e.g., Series 6—Investment Company and Variable Contracts Products Representative or Series 52—Municipal Securities Representative). The proposed rule change sets forth a process by which members and member organizations may seek a waiver from the Exchange of the on-site branch office manager requirement on a case-by-case basis, following prescribed criteria as set forth in the proposed Interpretation.

Background

Currently, except for “small offices,” all member and member organization branch offices are required to have an on-site qualified manager. The Interpretation of NYSE Rule 342.15 limits a small office to a total of three RRs. If an office has three or fewer RRs, the office is not required to have a qualified branch office manager on-site. Instead, the small office must be under the close supervision and control of the main office or other designated branch office that has a qualified branch office manager on-site. In addition, supervision and control procedures must be made part of the member’s or member organization’s written plan of supervision. Recently, member organizations with branch offices that have a limited scope of activities, but that don’t meet the definition of “small office” under the Interpretation, have approached the Exchange seeking relief from the requirement that such offices have a qualified branch office manager on-site.

As members and member organizations have been faced with ever changing demographics of their workforce, as well as with evolving

regulatory and market environments, many have responded by fundamentally altering the ways in which their business is conducted. For example, there has been a large increase in the number of small, multi-function offices that offer a combination of services related not only to securities brokerage, but also to banking and insurance products. Concurrently, advances in technology have resulted in increasingly sophisticated surveillance capabilities that enable members and member organizations to more effectively supervise and control the business activities of their associated persons in such offices from remote locations, such as another branch office or a firm’s main office.

Given these surveillance and monitoring capabilities, and the often-limited scope of securities-related business activities conducted in many offices, the requirement to have an on-site qualified branch office manager may often be neither practical nor necessary. Consequently, the Exchange has re-examined its “four-or-more” standard for requiring on-site supervision, and considered whether alternate criteria, such as limited securities sales activity coupled with proper risk-based supervisory controls and follow-up, should be determining factors for granting regulatory relief currently available only to small offices.³

Prior to the adoption of the Gramm-Leach-Bliley Act (the “GLBA”),⁴ banks were completely exempted from the definition of the terms “broker” and “dealer” under the Exchange Act.⁵ The GLBA amended the definition of these terms and replaced the full exception with functional exceptions. Thus, under the current terms of the Exchange Act, banks must either limit their securities activities to those that fit within the functional exceptions, or conduct those activities through a registered broker-dealer. As a result, many banks with affiliated broker-dealers have entered

³ See SR-NYSE-2002-34 (Definition of Branch Office). The Exchange has taken a similar risk-based approach in its definition of branch office and the exceptions to that definition for remote locations.

⁴ Pub. L. 106-102, 113 Stat. 1338 (1999). The GLBA lowered barriers between the banking and securities industries erected by the Banking Act of 1933 (known as the Glass-Steagall Act) Pub. L. 73-66, ch. 89, 48 Stat. 162 (1933) (codified in various sections of 12 U.S.C.).

⁵ 15 U.S.C. 78a *et seq.* (Before the GLBA, Exchange Act Section 3(a)(4) defined the term “broker” as “any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank. Before the GLBA, Exchange Act Section 3(a)(5) defined the term “dealer” as “any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank * * *”).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

into business arrangements with those broker-dealers to ensure that non-excepted "broker" or "dealer" activities are properly conducted.

One common practice is for the two entities to "dualy employ" those bank personnel acting in a broker or dealer capacity with both the bank and the registered broker-dealer. This enables banking personnel to register and qualify for securities license exam qualifications, such as the Series 6 (Investment Company and Variable Contracts Products Representative), the Series 7 (General Securities Registered Representative) and the Series 66 (Uniform Combined State Law), in order to conduct broker and dealer activities on behalf of the registered broker-dealer affiliate. Other broker-dealer alliances, primarily with insurance companies and investment companies, have also engaged in similar business arrangements involving dual employment and referrals among various registered entities.

Because the dually employed persons often primarily conduct business (*e.g.*, banking, insurance, mutual funds) other than broker or dealer activities, they typically physically remain on bank, insurance company, or investment company premises. However, because they are employees of the registered broker-dealer as well, the office is considered a branch office pursuant to NYSE Rule 342. If it is a branch office with more than three RRs, it is required to have a qualified branch office manager on-site. As noted above, the Interpretation of NYSE Rule 342 currently exempts only small offices—defined as offices with three or fewer RRs—from the on-site qualified branch office manager requirement.

This does not offer much flexibility to shared, multi-function broker-dealer offices that have more than three RRs but don't offer a full line of securities products and services. Often, offering a limited selection of securities products is an accommodation to the bank's, insurance company's or investment company's customers, and these products are complementary to such entities' traditional activities. In fact, many broker-dealer business models are becoming more reliant on offices of more than three RRs servicing geographically isolated locations with an abbreviated securities product/services menu. Because of the limited scope of securities-related business conducted in these offices, members and member organizations often have the technological capability to adequately supervise and control them without having a qualified branch office manager on-site.

Supervision

Pursuant to NYSE Rule 342, all offices of members and member organizations must be subject to an effective system of supervision and control. As broker-dealers have incorporated technological advancements into their business activities, they have been able to make greater use of electronic means to enhance overall supervision and control. For instance, firms have enacted policies and procedures that require their RRs to communicate through internal e-mail systems, which are used by supervisors and firms for monitoring and surveillance purposes. Centralized communication networks are likewise used to monitor the trading and handling of funds in customer accounts serviced in branch offices. All such activities are generally transacted through a broker-dealer's internal order management system, which feeds surveillance systems and exception reports.

The reports these systems can provide monitor activities as diverse as registration and continuing education status; daily trade review; new accounts review and approval; errors and corrections; employee trade and monthly statement review; outside business activity; selling away; customer address changes; customer complaints; blue sky monitoring; cancel and rebills; fund switch exceptions; missing documentation; various risk and product limits; and correspondence review and approval. With regard to correspondence, broker-dealers have utilized a variety of systems to organize electronic correspondence, such as e-mail, so that it can be monitored and reviewed in a timely manner. In addition, these systems have enabled firms to index, store and search e-mails for investigative and surveillance purposes.

Proposal

Given that the development of technologically sophisticated systems has automated and enhanced so many aspects of the supervisory process and expanded the range of supervisory functions that can be conducted remotely, the Exchange believes more flexibility and discretion is needed to determine whether a qualified on-site branch office manager is necessary for offices with more than three RRs if only a limited range of securities-related services is offered, or if a limited level of such activity is conducted. The proposed Interpretation would address this need. Further, it would give increased flexibility to member organizations that acquire new offices

through merger, acquisition or regulatory change, to structure their business activities in compliance with Exchange supervisory requirements.

Under the proposed Interpretation, members and member organizations seeking a waiver of the on-site qualified branch office manager requirement for limited purpose offices would be required to provide a written plan of risk-based supervision and control acceptable to the Exchange. Notwithstanding the grant of a waiver, all limited purpose offices would be required to be under the close supervision and control of a qualified person, as defined under NYSE Rule 342.13, at the main office or other designated branch office.

The Exchange believes that allowing a risk-based approach to supervision for limited purpose offices would benefit members' and member organizations' diverse business models while maintaining the integrity of their supervision and control systems. The proposed Interpretation sets forth factors to be used in determining whether a location qualifies as a limited purpose office and the supervisory requirements for each such office, including:

(i) The number of registered persons in the office (the RR to offsite Branch Office Manager ratio), their registration category, and the functions they perform (the nature and level of the RRs' responsibilities would be taken into account);

(ii) The scope and types of business activities conducted (in general, the nature of business should not pose special risks or otherwise warrant on-site supervision);

(iii) The nature and complexity of products and services offered (likewise, the products and services offered should not pose special risks or otherwise warrant on-site supervision);

(iv) The volume of business done (*e.g.*, annual revenues, number of transactions, number of customers, *etc.*). Locations with high activity levels would generally be deemed more likely to require an on-site manager);

(v) The adequacy of procedures to supervise the limited purpose office activities; and

(vi) The adequacy and independence of systems and supervisory persons for regular and "for cause" internal and third party inspections and audits.⁶

With respect to factors (v) and (vi) above, the Exchange expects members and member organizations to present a system of supervision and control

⁶ See also NYSE Info Memo 04-38 regarding independence of supervision and internal controls.

reasonably designed to detect and prevent regulatory violations and which otherwise meets the requirements of NYSE Rule 342. Such a system should include, but is not limited to, the following elements, where applicable: (1) Clearly articulated policies and procedures, and sufficient resources to implement them; (2) systematic monitoring of activity using routine and exception reporting criteria; (3) an appropriate system of follow-up and review if "red flags" are detected, and mechanisms for verifying that deficiencies are corrected; (4) routine and "for cause" inspections, including possible use of unannounced surprise inspections; (5) offsite monitoring of trading, handling of funds, and use of personal computers; (6) adequate designation of supervisors and clearly delineated supervisory responsibilities, including a system of review and follow-up to ensure that such supervision is sufficiently independent and is diligently exercised; (7) monitoring of outside business activities and outside accounts; (8) monitoring and surveillance of internal and external communications; and (9) the education and training of RRs and their supervisors to ensure they understand their responsibilities under the firm's procedures and all applicable securities laws.

In addition to the elements enumerated above, members and member organizations should also take into consideration relevant guidance provided by the Exchange and other regulatory bodies when developing their supervisory plan for a proposed limited purpose office.⁷

All of the above factors will be considered as a whole to determine whether an application for limited purpose office status should be granted. However, any one factor could cause an application to be delayed or rejected by the Exchange if it raises a substantive issue with respect to the appropriateness or advisability of a remote supervisory arrangement. If an application for limited purpose office status encompasses more than one office, pursuant to a categorical description or plan, the member organization must submit the proposed list of prospective offices so as to disclose the scope of the request.

Members and member organizations will be responsible for maintaining a readily available, current and accurate

list of all locations either specifically approved and designated by the Exchange as a limited purpose office, or otherwise designated as such pursuant to a general categorical description or plan approved by the Exchange. Further, any material change with respect to the representations made by any member or member organization pursuant to this Interpretation with respect to any location so approved and designated must be promptly brought to the attention of the Exchange for reconsideration.

2. Statutory Basis

The basis for the proposed rule change is the requirement under Section 6(b)(5)⁸ of the Exchange Act that the rules of the Exchange 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.

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

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

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

The Exchange has neither solicited nor received written comments on the proposed rule change.

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 Exchange 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. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSE-2004-51 on the subject line.

Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-9303.

All submissions should refer to File Number SR-NYSE-2004-51. 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, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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, 100 F Street, NE., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSE-2004-51 and should be submitted on or before November 15, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Jonathan G. Katz,
Secretary.

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⁷ See, e.g., NYSE Info Memo 04-38 (Amendments to Rules 342, 401, 408 and 410 Relating to Supervision and Internal Controls) (July 26, 2004); SEC Division of Market Regulation Staff Legal Bulletin No. 17: Remote Office Supervision (March 19, 2004).

⁸ 15 U.S.C. 78f(b)(5).

⁹ 17 CFR 200.30-3(a)(12).