

# Notice to Members

SEPTEMBER 2003

## SUGGESTED ROUTING

Continuing Education  
Legal & Compliance  
Registration  
Senior Management

## KEY TOPICS

Continuing Education  
Firm Element

INFORMATIONAL

## Continuing Education

Securities Industry/Regulatory Council on Continuing Education Issues Firm Element Advisory

### Executive Summary

The Securities Industry/Regulatory Council on Continuing Education (Council) has issued the annual *Firm Element Advisory*, a guide for firms to use when developing their continuing education Firm Element training plans. The Council recommends that firms use the *Firm Element Advisory* as part of the Firm Element Needs Analysis to help identify relevant training topics for all covered persons, including supervisors. New rules or regulations, such as the Research Analyst Rules; major regulatory examination findings, such as those relating to mutual fund sales practices; ethics and professional conduct; and any new products or services the firm plans to offer should be considered as topics for Firm Element training.

All of the training resources found in the *Firm Element Advisory* may be found on the CE Council Web Site at [www.securitiescep.com](http://www.securitiescep.com), where there are also two additional Firm Element resources. The first is the *Firm Element Organizer*, an easy-to-use software application that enables a search of an extensive database of training resources related to specific investment products or services. The second resource comprises CDs with scenarios taken from the Regulatory Element Supervisor (S201) and General (S101) programs. Log on to the Council Web Site for descriptions of the available scenarios.

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## Questions/Further Information

Questions concerning this *Notice* may be directed to John Linnehan, Director, Continuing Education, at (240) 386-4684.

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The Securities Industry Continuing Education Program

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## Securities Industry Continuing Education Program Firm Element Advisory

Each year the Securities Industry/Regulatory Council on Continuing Education (Council) publishes the *Firm Element Advisory* to identify current regulatory and sales practice issues for possible inclusion in Firm Element training plans. This year's topics have been taken from a review of industry regulatory and self-regulatory organization (SRO) publications issued since the last *Firm Element Advisory* of October 2002.

The Council recommends that firms use the *Firm Element Advisory* as part of a firm's Firm Element Needs Analysis to identify training topics that are relevant to the firm, including training for supervisors. New rules or regulations, such as the Research Analyst Rules; major regulatory examination findings, such as those relating to mutual fund sales practices; ethics and professional conduct; and any new products or services the firm plans to offer should be considered as topics for Firm Element training.

The Council provides a convenient way for firms to access the training resources listed next to each topic in the *Firm Element Advisory*—the CE Council Web Site at [www.securitiescep.com](http://www.securitiescep.com). In addition to the *Firm Element Advisory* material, there are also two additional resources to assist with Firm Element requirements. The first is the *Firm Element Organizer*. This is an easy-to-use software application that enables you to search an extensive database of training resources related to specific investment products or services you identify. The results of a search can then be edited into a document that will assist developing a Firm Element training plan. A tutorial on the CE Council Web Site demonstrates how to use the *Firm Element Organizer*. The second potential Firm Element resource comprises scenarios taken from the Regulatory Element Supervisor (S201) and General (S101) programs that may be suitable for Firm Element training.

For more information, log on to [www.securitiescep.com](http://www.securitiescep.com), or phone Roni Meikle, Continuing Education Manager, New York Stock Exchange (212-656-2156), or John Linnehan, Director, Continuing Education, NASD (240-386-4684).

## Training Topics and Relevant Training Points and References

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### Anti-Money Laundering

Anti-money laundering is an evolving topic. Many new rules and regulations have been adopted over the past two years to carry out the mandates of the USA PATRIOT Act. These requirements place additional due diligence, reporting, and training responsibilities on firms, supervisors, and registered representatives. Many SROs and government agencies maintain Web sites on anti-money laundering, including NASD ([www.nasdr.com/money.asp](http://www.nasdr.com/money.asp)), the U.S. Treasury ([www.ustreas.gov](http://www.ustreas.gov) => Bureaus => Financial Crimes Enforcement Network (FinCen) ([www.fincen.gov](http://www.fincen.gov))), and the SIA ([www.sia.com](http://www.sia.com) => Reference Materials => Anti-Money Laundering Guidance).

See also, MSRB Notice 2003-28 (July 16, 2003), Approval by SEC of Rule G-41, on *Anti-Money Laundering Compliance*, NASD Notice To Members 02-47, *Anti-Money Laundering: Treasury Issues Final Suspicious Activity Reporting Rule For Broker/Dealers*, August 2002; NASD Notice to Members 03-34, *Anti-Money Laundering Customer Identification Programs for Broker/Dealers*, June 2003, and NYSE Information Memos 03-32, *Customer Identification Programs For Broker-Dealers*, July 14, 2003; 03-03, *Lifting Of The Temporary Moratorium On Information Requests Under Section 314 Of The USA PATRIOT Act*, February 20, 2003; 02-64, *USA PATRIOT Act Updates: Section 356 Requirement To Report Suspicious Transactions; Deadline Extension For Sections 313 And 319*, December 24, 2002; 02-46, *Compliance With Section 326 ("Verification Of Identification") Of The USA PATRIOT Act*, October 31, 2002 ([www.nyse.com](http://www.nyse.com) => Regulation => Information Memos).

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### Brokered Certificates of Deposit

NASD and the NYSE have provided guidance to their members that offer non-traditional certificate of deposit (CD) products. Typically, these products are long-term CDs offered by "deposit brokers" that carry a maturity date of more than one year, are callable at the discretion of the issuer, and trade in a secondary market. In certain circumstances, these products are securities. Irrespective of whether a particular CD product is a security, members must ensure that their registered representatives are properly trained and informed about the products, and that customers receive adequate disclosure of risk factors. Members are advised to carry CD products at fair market value on customer account statements. See *Notice to Members 02-69, Certificates of Deposit: Clarification of Member Obligations Regarding Brokered Certificates of Deposit*, October 2002; NYSE Information Memo 01-19, *Long-Term Certificates Of Deposit – Sales Practices*, July 20, 2001 ([www.nyse.com](http://www.nyse.com) => Regulation => Information Memos).

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## **Business Conduct**

### *Ethics*

Firms should be aware of the importance of ethics and professional responsibility as topics to include in their Firm Element training programs. Although the Securities Industry/Regulatory Council on Continuing Education (CE Council) will enhance the Regulatory Element programs via the introduction of scenarios and cases that will stress awareness of the ethical dimension to situations involving conflicts of interest, peer pressure, reputational risk, etc., Firm Element programs have certain advantages. Firm Element programs can utilize small, personal, and interactive training settings where different viewpoints and values can be expressed, evaluated, and shared. They can also deal with issues that are specific to the firm.

Beginning in 2004, when amendments to SRO continuing education rules regarding research analysts become effective (see *Research Analysts' Conflicts of Interest*, below), research analysts will be required to be registered and will be subject to the Firm Element as well as the Regulatory Element. Firm Element training for research analysts, and their immediate supervisors, must include ethics, professional responsibility, and other more specific topics. While not mandated for all other registered persons, the CE Council urges firms to carefully consider ethics and professional responsibility as they relate to other Firm Element training topics.

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### *Guarantees and Sharing in Customer Accounts*

On February 12, 2003, the Securities and Exchange Commission (SEC) approved amendments to NASD Rules 2330(e) (Prohibition Against Guarantees) and 2330(f) (Sharing in Accounts; Extent Permissible). The amendments to Rule 2330(e) clarify that members and their associated persons are prohibited from guaranteeing any customer against loss in connection with any securities transaction or in any securities account of the customer. Rule 2330(f) has been amended to require that associated persons obtain prior written authorization from their employing member firm and that members and associated persons obtain prior written authorization from the customer before sharing in a customer's account. The amendments also delete from Rule 2330(f) the requirement that members and associated persons obtain the prior written authorization of the member carrying the account before sharing in a customer's account. See *NASD Notice to Members 03-21, Prohibition Against Guarantees and Sharing in Customer Accounts*, April 2003. See also NYSE Rule 352 (Guarantees and Sharing in Accounts) related to this topic.

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**Hedge Funds**

Broker/dealers that offer hedge funds to their clients must fulfill their obligations to 1) provide balanced disclosure in promotional efforts; 2) perform a reasonable-basis suitability determination; 3) perform a customer-specific suitability determination; 4) supervise associated persons selling hedge funds and funds of hedge funds; 5) train associated persons regarding the features, risks, and suitability of hedge funds. See *NASD Notice to Members 03-07, NASD Reminds Members of Obligations When Selling Hedge Funds*, February 2003, and *NASD Investor Alert, Funds Of Hedge Funds – Higher Costs And Risks For Higher Potential Returns*, August 23, 2002, at [www.nasdr.com/alert\\_hedgefunds.htm](http://www.nasdr.com/alert_hedgefunds.htm).

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**Municipal Fund Securities****529 Plan Sales  
Material**

The market for municipal fund securities, especially Section 529 College Savings Plans, is growing. Municipal fund securities represent investments in pools of securities, such as securities issued by registered investment companies. Municipal fund securities are municipal securities regulated by the MSRB. All sales materials related to them must comply with MSRB rules, including MSRB Rule G-21. In addition, certain sales materials for municipal fund securities must also comply with the advertising rules of the SEC and NASD, including NASD Rule 2210. See *NASD Notice to Members 03-17, Municipal Fund Securities: Sales Material for Municipal Fund Securities*, March 2003.

Principals supervising the sale of municipal fund securities must be appropriately qualified and hold either a Series 53 or Series 51 license. For more information, see NASD's Web Site at [www.nasd.com/Investor/Choices/College/](http://www.nasd.com/Investor/Choices/College/) and the MSRB Web Site at [ww1.msrb.org/msrb1/mfs/default.asp](http://ww1.msrb.org/msrb1/mfs/default.asp).

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**Sales to  
Employees of  
Other Dealers**

MSRB Rule G-28 has been amended to exempt transactions in municipal fund securities from the requirement that a dealer opening an account for another dealer's employee (or a spouse or child of the employee) provide notice to the other dealer and follow the other dealer's instructions with respect to transactions for the employee (or spouse or child).

See MSRB Notice 2003-9 (March 4, 2003), *SEC Approves Amendment to Rule G-28 on Sales to Employees of Other Dealers* ([ww1.msrb.org/msrb1/archive/G-28approval.htm](http://ww1.msrb.org/msrb1/archive/G-28approval.htm)).

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**Municipal Securities***Consultants*

MSRB Rule G-38 defines a consultant as any person used by a dealer to obtain or retain municipal securities business through direct or indirect communication by such person with an issuer on the dealer's behalf where the communication is undertaken by such person in exchange for, or with the understanding of, receiving payment from the dealer or any other person. Dealers must disclose to issuers certain information about their consultants and report certain information about their consultants to the MSRB on Form G-37/G-38, including certain of their consultants' political contributions to issuer officials and payments to state and local political parties.

See MSRB Rule G-38: Consultants, *MSRB Rule Book*.

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*Political Contributions and Prohibitions on Municipal Securities Business*

A recent rule change revised the definition of municipal finance professional (MFP) so that associated persons "primarily engaged" in municipal securities representative activities based on their retail sales of municipal securities are excluded from the definition. Any retail sales representatives who solicit municipal securities business from issuer officials remain covered under the rule as MFPs.

The look back and look forward provisions have been revised. The revisions produce the following results:

**MFPs primarily engaged in municipal securities representative activities:** The two-year look back is retained, and the look forward is reduced to one year.

**Solicitor MFPs:** The two-year look back is retained, but limited only to contributions to officials of the issuer solicited, and the look forward is reduced to one year.

**Supervisor and management-level MFPs:** The look back is reduced to six months and the look forward is reduced to one year.

Dealers are prohibited from engaging in municipal securities business with a municipal securities issuer within two years after any contribution to an official of such issuer made by the dealer, any MFP, or any political action committee controlled by the dealer. A dealer that has triggered the ban may seek an exemption from the appropriate regulatory agency, or, in certain limited circumstances, use an automatic exemption. MSRB Rule G-37 describes relevant factors to be considered by the appropriate regulatory agency in determining whether to grant an exemption.

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See MSRB Notice 2003-25 (June 30, 2003), *Electronic G-37 Submission System (eG-37 System) Becomes Operational* ([www.msrb.org/msrb1/archive/eG-37AnnouncementNotice.htm](http://www.msrb.org/msrb1/archive/eG-37AnnouncementNotice.htm)); and MSRB Notice 2003-17 (May 12, 2003), *SEC Approves Amendments to Rule G-37 Revising the Exemption Process and the Definition of Municipal Finance Professional* ([www1.msrb.org/msrb1/archive/G-37approval503.htm](http://www1.msrb.org/msrb1/archive/G-37approval503.htm)).

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*Qualifications*

Dealers are required to ensure that their supervisors are appropriately qualified for their area of responsibility. The principal who serves as the primary contact for electronic communications from the MSRB must be qualified as a municipal securities principal or a municipal fund securities limited principal. The individual who is directly engaged in the functions of a municipal securities principal in a firm that limits its municipal securities activities to municipal fund securities must be qualified as a municipal securities principal or a municipal fund securities limited principal.

See MSRB Notice 2003-6 (February 28, 2003), *Reminder: To Supervise Municipal Fund Securities Activities, a Municipal Fund Securities Limited Principal (Series 51) or Municipal Securities Principal (Series 53) Qualification is Required by April 1, 2003* ([www1.msrb.org/msrb1/archive/noticeG-3.htm](http://www1.msrb.org/msrb1/archive/noticeG-3.htm)); and MSRB Notice 2003-26 (July 1, 2003), *Notice of Technical Amendments to Form G-40, on E-Mail Contacts* ([www1.msrb.org/msrb1/archive/G-40Revisedform.htm](http://www1.msrb.org/msrb1/archive/G-40Revisedform.htm)).

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*Transaction Reporting*

Broker/dealers have an obligation to report their municipal securities transactions to the MSRB accurately and on time. Transaction information is made available to the public, and to the NASD and other regulators for market surveillance and enforcement activities.

See *NASD Notice to Members 03-13, MSRB Rules G-12 and G-14: NASD Reminds Firms about Transaction Reporting Requirements and Announces Enforcement Actions Against Firms for Violations of MSRB Transaction Reporting Rules G-12 and G-14*; MSRB Notice 2003-7 (March 3, 2003), *Reminder Regarding MSRB Rule G-14, Transaction Reporting Requirements* ([www1.msrb.org/msrb1/archive/TRSnotice0203.htm](http://www1.msrb.org/msrb1/archive/TRSnotice0203.htm)); see also the section on Municipal Price Reporting/Transaction Reporting System on the MSRB Web Site, [www.msrb.org](http://www.msrb.org).



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## Mutual Funds

### *Breakpoints and Share Classes*

Failure to provide customers with appropriate mutual fund discounts is conduct that violates SRO rules. NASD has issued *Special Notice to Members 02-85 (NASD Requires Immediate Member Firm Action Regarding Mutual Fund Purchases and Breakpoint Schedules*, December 2002) and two Investor Alerts regarding mutual funds to make investors aware of share classes and breakpoints. Broker/dealers should remind their associated persons of their obligation to ensure that their clients are charged the lowest possible front-end sales charge. See NASD Investor Alerts: *Class B Mutual Fund Shares: Do They Make the Grade?* ([www.nasdr.com/alert\\_classb\\_funds.htm](http://www.nasdr.com/alert_classb_funds.htm)), dated June 25, 2003; *Mutual Fund Breakpoints: A Break Worth Taking* ([www.nasdr.com/alert\\_breakpoint.htm](http://www.nasdr.com/alert_breakpoint.htm)), and *Understanding Mutual Fund Share Classes* ([www.nasdr.com/alert\\_mfclasses.htm](http://www.nasdr.com/alert_mfclasses.htm)), both dated January 14, 2003.

Note that the *Report of the Joint NASD/Industry Task Force on Breakpoints* ([www.nasdr.com/breakpoints\\_report.asp](http://www.nasdr.com/breakpoints_report.asp), page 15) recommends greater focus on breakpoint rules, terms, and considerations in Firm Element training.

To stay current on this important topic, firms should monitor NASD's Breakpoint Web Site: [www.nasdr.com/breakpoints\\_members.asp](http://www.nasdr.com/breakpoints_members.asp).

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### *Late Trades and Market Timing*

Investment Company Act Rule 22c-1(a) generally requires that redeemable securities of investment companies be sold and redeemed at a price based on the net asset value (NAV) of the fund computed after the receipt of orders to purchase. It is a violation of NASD Rule 2110 (Standards of Commercial Honor and Principles of Trade), and may be a violation of the federal securities laws and NASD Rule 2120 (Use of Manipulative, Deceptive or Other Fraudulent Devices), for member firms and their associated persons to knowingly or recklessly effect mutual fund transactions that are priced based on NAV that is computed prior to the time the order to purchase or redeem was given by the customer. Furthermore, it may be a violation of NASD Rule 2110 and the federal securities laws to knowingly or recklessly facilitate certain mutual fund transactions, such as market timing transactions, in conjunction with, or with the acquiescence of, a mutual fund sponsor, fund administrator, investment adviser, underwriter, or any other affiliated person where those other parties acted contrary to a representation made in the prospectus or statement of additional information pursuant to which the mutual fund shares are offered.

See *NASD Special Notice to Members 03-50, Mutual Fund Transactions: NASD Reminds Member Firms of Their Obligations Regarding Mutual Fund Transactions and Directs Review of Policies and Procedures*, September 2003.

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**Options***Supplement to the  
Options Disclosure  
Document*

The SEC approved the Options Clearing Corporation's supplement to the Options Disclosure Document (ODD) relating to:

- 1) Options on Investment Companies and Similar Entities
- 2) Special Exercise Settlement Procedures or Restrictions that may be imposed upon the occurrence of certain extraordinary events;
- 3) Disclosure that a Registration Statement and Prospectus will no longer be available from the OCC or U.S. options exchanges.

See CBOE Regulatory Circular RG03-12 dated March 5, 2003, *Supplement to the Options Disclosure Document Regarding Exercise Settlement Values*.

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**OTC Equity  
Securities**

On August 22, 2002, the SEC approved new NASD Rule 2315, (Recommendations to Customers in OTC Equity Securities) [Recommendation Rule]. Rule 2315 is intended to address abuses in transactions involving thinly capitalized (microcap) securities. The Rule mandates that a member conduct a due diligence review of an issuer's current financial and business information before recommending that issuer's microcap securities. Since the Rule does not supercede existing member obligations when recommending a security, e.g., suitability determination, compliance with Rule 2315 does not provide a safe harbor from an RR's responsibility to determine the appropriateness of such securities for each prospective customer. See *NASD Notice to Members 02-66, OTC Equity Securities: SEC Approves NASD Rule 2315; Recommendations to Customers in OTC Equity Securities*, October 2002.

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**Outside Business  
Activities and  
Private Securities  
Transactions**

A registered person who sells a security away from his or her firm without first obtaining written approval from the firm violates NASD Rule 3040, and a registered person who engages in an outside business activity without prior notice to his or her firm, including the sale of non-securities products, violates NASD Rule 3030. Registered persons are advised to provide written notice to their firms before they engage in the sale of any financial instrument that is not approved by their firm. NYSE Rule 407 states that associated persons obtain their employers' written approval prior to establishing or monitoring securities or commodities accounts or entry into private securities transactions. See also NYSE Information Memo 02-40, *Amendments To Rule 407 Relating To Private Securities Transactions*, August 28, 2002 ([www.nyse.com](http://www.nyse.com) => Regulation => Information Memos).

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SEC-approved amendments to CBOE rules require non-supervisory associated persons who are registered and who engage in outside business activities to provide written notice to the member organization that employs them and receive the member's prior written consent for such outside activities. With respect to persons registered as ROPs, FinOps, or Sales Supervisors of member organizations of which the CBOE is the Designated Examining Authority, such individuals must have prior written authorization from the member firm prior to engaging in any outside business activity. The member firm is also required to provide prompt written notice to the CBOE of any outside business of registered supervisory personnel.

See CBOE Regulatory Circular RG03-37 dated June 9, 2003, *Other Affiliations of Registered Associated Persons*.

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**Principal-  
Protected Funds**

The recent bear market has left many investors worried more about securing the return of their investment dollars than about the return on their investments. Some have turned to new types of mutual funds that pledge to guarantee, for a set period of time, that the capital invested in the mutual fund or in a variable annuity's sub-accounts will be kept safe—for a price. These products are known as "principal-protected" funds (or, alternatively, principal protection, capital preservation, or guaranteed funds). Associated persons should be trained in the features, risks, and suitability of principal-protected funds and explain to their clients how they work and what they cost. See NASD Investor Alert, *Principal-Protected Funds – Security Has a Price*, ([www.nasdr.com/alert\\_principal\\_protected\\_funds.htm](http://www.nasdr.com/alert_principal_protected_funds.htm)), dated March 27, 2003.

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**Registration and  
Reporting  
Requirements**

*Criminal and Civil  
Complaints and  
Arbitration Claims*

On March 3, 2003, the SEC approved a proposal to amend NASD Rule 3070 to require members promptly to file with NASD copies of certain criminal and civil complaints and arbitration claims that name a member or an associated person as defendant or respondent. The amendment requires members promptly to file with NASD copies of the following documents: (1) any criminal complaints filed against the member or plea agreements entered into by the member that are covered by Rule 3070; (2) any securities or commodities-related private civil complaints filed against the member; (3) any arbitration claim against the member; and (4) any criminal complaint or plea agreement, private civil complaint, or arbitration claim against an associated person that is reportable under question 14 on Form U4, irrespective of any dollar threshold requirements that question imposes for notification. See *NASD Notice to Members 03-23, Rule 3070: SEC Approves Amendment to Rule 3070 to Require Filing with NASD of Criminal and Civil*

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*Complaints and Arbitration Claims, May 2003. See also NYSE Information Memos 03-11, Fingerprint Processing And FBI Identification Records, March 25, 2003, and 02-52, New Forms U-4 AND U-5 Filing Procedures Through Web CRD, November 18, 2002 (www.nyse.com) => Regulation => Information Memos).*

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**Research Analysts'  
Conflicts of  
Interest**

On May 10, 2002, the SEC approved new NASD Rule 2711 (Research Analysts and Research Reports), as well as amendments to New York Stock Exchange (NYSE) Rule 351, (Reporting Requirements), and Rule 472, (Communications With The Public). The intent of the new rule and rule amendments is to increase research analysts' independence from influences within their firms and provide disclosure of conflicts of interests that might potentially bias research analysts and the research reports they produce. Generally, the new rule and amendments: 1) restrict the relationship between research and investment banking departments; 2) require disclosure of financial interests in subject companies by analysts and firms; 3) require disclosure of existing and potential investment banking relationships with subject companies; 4) impose quiet periods for the issuance of research reports; 5) restrict personal trading by analysts; and 6) require disclosure of information that assists investors in tracking the correlation between analysts' recommendations and stock price movement.

On July 29, 2003, the SEC approved further amendments to these rules. The amendments are the latest in a series of joint regulatory efforts intended to address broker/dealer and analyst conflicts of interest and to enhance public disclosure of such potential conflicts of interest. The amendments also amend NASD/NYSE rules to comply with the mandates of the Sarbanes-Oxley Act of 2002, and impose registration, qualification, and continuing education requirements on research analysts. When the amendments to SRO Continuing Education Rules become effective in 2004, research analysts will be required to be registered and will be subject to the Regulatory Element and the Firm Element. Firm Element training for research analysts and their immediate supervisors will be required to include ethics, professional responsibility, and the requirements of new Research Analyst rules, e.g., NASD Rule 2711.

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See *NASD Notice to Members 03-44: Research Analysts and Research Reports*, August 2003; NYSE Information Memos 03-36, *Amendments to Disclosure and Reporting Requirements*, August 25, 2003; 03-30, *RULE 472 - Gatekeeper Requirements*, July 10, 2003; 03-12, *April 1st Reporting Requirement - Rules 351 & 472*, March 25, 2003; *Disclosure and Reporting Requirements Nos 02-55*, November 29, 2002, and 02-30, July 9, 2002 ([www.nyse.com](http://www.nyse.com) => Regulation => Information Memos).

See also *NASD Notice to Members 02-39: SEC Approves Rule Governing Research Analysts' Conflicts of Interest*, July 2002; and *SEC Regulation Analyst Certifications (Reg AC)* at [www.sec.gov/rules/final/33-8193.htm](http://www.sec.gov/rules/final/33-8193.htm).

NASD maintains a Web Site on this evolving topic that is continuously updated at [www.nasdr.com/analyst\\_guide.htm](http://www.nasdr.com/analyst_guide.htm)

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**Security Futures  
(also know as  
Single Stock  
Futures)**

The Commodity Futures Modernization Act of 2000 lifted the ban on the trading of security futures (*i.e.*, futures on narrow-based indices, single stocks, and options on securities futures). Because security futures have different characteristics and requirements than existing securities, the SROs have adopted rules that require any currently registered securities professional that intends to engage in a security futures business or to supervise such activity to complete a training program covering security futures, which may be included as Firm Element training for the pertinent registered persons. The SROs have also developed a content outline for use in the development of the training program, which focuses on the essential information individuals and supervisors should know before conducting a securities futures business. The content outline has five modules:

- 1) Stocks and Stock Options
- 2) Futures Contracts
- 3) Security Futures
- 4) Regulatory Requirements for Security Futures
- 5) Supervision of the Offer and Sale of Security Futures.

An individual's current registration category will determine which of these modules must be completed before engaging in a security futures business. Series 7 registrants, for example, may not need to participate in the training on Stocks and Stock Options. Therefore, a member firm must consider the registration category and qualifications of persons in determining the nature and scope of his or her training.

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Firms may develop their own securities futures training program or may engage a third party provider to deliver the training program, so long as the training provided encompasses all appropriate subjects in the SRO-developed content outline. Firms remain responsible for compliance with SRO rules in all respects where training is developed and or administered by outside parties. NASD and the NFA have developed a Web-based security futures training program that, if completed in the prescribed manner, would satisfy the required training requirement. Information regarding this training program can be obtained at [www.nasdr.com/futures.asp](http://www.nasdr.com/futures.asp). Note: Securities and futures SROs are in the process of developing regulatory requirements for the registration and qualification of persons engaged in security futures contracts sales and supervision activities. Please monitor the NASD Web Site and these other SRO Web sites for additional information: [www.nfa.futures.org](http://www.nfa.futures.org), [www.nyse.com](http://www.nyse.com), and [www.amextrader.com](http://www.amextrader.com).

Broker/dealers need to maintain records of the completion of any security futures training program designed to satisfy the requirement. Members may be required during an examination or investigation to demonstrate that individuals who are engaged in a security futures business have completed the required training.

For more information on security futures in general, please see: [www.nqix.com](http://www.nqix.com) and [www.onechicago.com](http://www.onechicago.com).

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## **Supervision**

### *Books and Records*

Branch office managers and other supervisory personnel, as well as RRs, should be aware of SEC-approved amendments to the broker/dealer Books and Records Rules, Rule 17a-3 and Rule 17a-4 under the Securities Exchange Act of 1934, that became effective on May 2, 2003. The amendments clarify and expand recordkeeping requirements in connection with purchase and sale documents, customer records, associated person records, customer complaint records, and certain other matters. The amendments also require broker/dealers to maintain or promptly produce certain records at each office to which those records relate.

Some of the more significant aspects of the Books and Records Rules are:

- ◆ The definition of "office."
- ◆ Updating Customer Account Records.
- ◆ Additional Information Annotated on Order Tickets.
- ◆ Additional Records Related to Associated Persons.
- ◆ Retention of Communications With the Public.

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For more information, see NASD's Books and Records Web Site at [www.nasdr.com/books.asp](http://www.nasdr.com/books.asp), which has links to the following: *SEC Interpretive Release: Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934, Rel. 34-47910 (5/29/03)*; *NASD Notice to Members 01-80, Books and Records Rules: Amendments To Broker/Dealer Books And Records Rules Under The Securities Exchange Act Of 1934*, December 2001; and *Frequently Asked Questions*.

See also NYSE Information Memos 03-18, *I. Amended Rule 36, (Communications Between Exchange And Members' Offices) – Cell Phones, And Requirements For Conducting A Public Business II. Clarification Of Recent SEC Books And Records Rules*, May 6, 2003, and 03-16, *Effective Date For "Books And Records" Rule Amendments*, April 15, 2003 ([www.nyse.com](http://www.nyse.com) => *Regulation => Information Memos*).

Also see CBOE Regulatory Circular RG03-032 dated May 2, 2003, *Effective Date for "Books and Records" Rule Amendments*, and PHLX Membership Memo 0551-03 dated May 5, 2003, *Amendments to Broker-Dealer Books and Records Rules*.

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*General Topics*

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Industry continuing education rules require a broker/dealer to include supervisory training for supervisors if its Firm Element Needs Analysis establishes the need for it. Supervisors should be trained on new rules with general application, e.g., anti-money laundering, as well as new rules relating to new products, if applicable. Firms should reiterate with supervisors the importance of internal controls as they relate to areas such as changing customer addresses, Letters of Authorization, mail directed to customer post office boxes, time and price discretionary orders, and supervision of producing managers.

Broker/dealers may also find it helpful to periodically review with their supervisors various examples of conduct that violates SRO rules, such as:

- ◆ Exercising Discretion Without Prior Written Authority
- ◆ Failure to Respond to SRO Information Requests
- ◆ Failure to Provide Customers With Mutual Fund Breakpoints
- ◆ Falsifying Documents
- ◆ Forgery
- ◆ Misrepresentations to Customers
- ◆ Selling Away
- ◆ Unsuitable Recommendations
- ◆ Unauthorized Trading

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Supervisors in turn may wish to share this information with the registered persons they supervise. Many industry SROs publish information on their Web sites that illustrate improper conduct and the disciplinary action taken by regulators. For example: NASD's quarterly *Disciplinary Update* at [www.nasdr.com/disc\\_update\\_index.asp](http://www.nasdr.com/disc_update_index.asp), and NYSE's Disciplinary Actions at [www.nyse.com/regulations.html](http://www.nyse.com/regulations.html).

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### *Instant Messaging*

Instant messaging is a developing technology that can pose supervisory and recordkeeping challenges for member firms. Instant Messaging's lack of formality does not exempt it from the general standards applicable to all forms of communication with the public. Broker/dealers must supervise the use of instant messaging consistent with the required supervision of e-mail messaging. Depending on the circumstances, instant messaging could be either sales literature or correspondence. Compliance in each of these situations depends on clear supervision and review procedures that are consistently followed. If a member is unable to establish an adequate supervisory program, the member must prohibit the use of instant messaging in customer communication. Broker/dealers must also ensure that their use of instant messaging complies with applicable SEC and SRO recordkeeping requirements. See *NASD Notice to Members 03-33, Instant Messaging: Clarification for Members Regarding Supervisory Obligations and Recordkeeping Requirements for Instant Messaging*, July 2003.

Also, broker/dealers are required pursuant to NYSE Rule 440 and SEC Rules 17a-3 and 17a-4 to retain records that relate to the conduct of their business. Instant messaging, while a new format for communications, is subject to the same retention requirements as any other form of written or electronic communications. See Information Memo 03-7, *Electronic Logs And Record Retention*, March 5, 2003 ([www.nyse.com](http://www.nyse.com) => *Regulation* => *Information Memos*).



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## **Variable Annuities and Life Insurance**

Associated persons should be trained in the features, risks, and suitability of variable annuity and life insurance contract exchanges so as to assist their clients in making informed decisions. NASD has published a number of Investor Alerts on this subject:

- ♦ *Should You Exchange Your Variable Annuity?*  
([www.nasdr.com/alert\\_annuityexchanges.htm](http://www.nasdr.com/alert_annuityexchanges.htm))  
February 15, 2001
- ♦ *Should You Exchange Your Life Insurance Policy?*  
([www.nasdr.com/alert\\_exchange\\_lifeinsurance.htm](http://www.nasdr.com/alert_exchange_lifeinsurance.htm))  
September 23, 2002
- ♦ *Variable Annuities: Beyond the Hard Sell,*  
([www.nasdr.com/alert\\_variable\\_annuities.htm](http://www.nasdr.com/alert_variable_annuities.htm))  
May 27, 2003

See also *NASD Notice to Members 99-35, The NASD Reminds Members of Their Responsibilities Regarding the Sale of Variable Annuities*, May 1999; and *Variable Annuities: What You Should Know*, at [www.sec.gov/consumer/varannty.htm](http://www.sec.gov/consumer/varannty.htm).

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## To Obtain More Information

For more information about publications contact the SROs at these addresses:

<b>Self-Regulatory Organization</b>	<b>Address and Phone Number</b>	<b>Online Address</b>
American Stock Exchange	American Stock Exchange Marketing Department 86 Trinity Place New York, NY 10006 800-THE-AMEX	<a href="http://www.amex.com">www.amex.com</a> <a href="http://www.amextrader.com">www.amextrader.com</a>
Chicago Board Options Exchange	Chicago Board Options Exchange 400 S. LaSalle Street Chicago, IL 60605 877-843-2263 e-mail: <a href="mailto:help@cboe.com">help@cboe.com</a>	<a href="http://www.cboe.com">www.cboe.com</a>
Municipal Securities Rulemaking Board	MSRB Publications Department 1900 Duke Street Suite 600 Alexandria, VA 22314 703-797-6600	<a href="http://www.msrb.org">www.msrb.org</a>
NASD	NASD MediaSource P.O. Box 9403 Gaithersburg, MD 20898-9403 240-386-4200	<a href="http://www.nasd.com">www.nasd.com</a>
New York Stock Exchange	New York Stock Exchange Publications Department 11 Wall Street 18th Floor New York, NY 10005 212-656-5273 or 212-656-2089	<a href="http://www.nyse.com">www.nyse.com</a>
Philadelphia Stock Exchange	Philadelphia Stock Exchange Marketing Department 1900 Market Street Philadelphia, PA 19103 800-THE PHLX or 215-496-5158	<a href="http://www.phlx.com">www.phlx.com</a>