

Notice to Members

OCTOBER 2002

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 attached *Firm Element Advisory* lists topics that the Council considers to be particularly relevant to the industry at this time. The list is based on a review of recent regulatory events, as well as advisories issued by self-regulatory organizations (SROs) since the last Firm Element Advisory of November 2001. Firms should review the training topics listed in the *Firm Element Advisory* in conjunction with their annual Firm Element Needs Analysis in which firms identify training issues to be addressed by their written Firm Element training plan(s).

Also, please note that the Council has two additional resources available on its Web Site to assist firms with Firm Element requirements. The first is the *Firm Element Organizer*, an easy-to-use software application in which the user identifies specific investment products or services and selects training topics from a defined list. The *Firm Element Organizer* then searches an extensive database of training resources like those listed in the *Firm Element Advisory*, and provides a report of relevant resources. The report can then be edited into a Firm Element training plan using a word processing program. A tutorial on the Web Site demonstrates this process. The second Firm Element resource comprises scenarios taken from the Regulatory Element computer-based training that may be suitable for Firm Element training. For more information, to use the *Firm Element Organizer*, or to order Regulatory Element scenarios, log on to www.securitiescep.com.

Questions/Further Information

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

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The Securities Industry Continuing Education Program

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 pertinent 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 November 2001.

The Council recommends that firms use the *Firm Element Advisory* when they undertake their annual Firm Element Needs Analysis. Begin by reviewing the training topics listed in the *Firm Element Advisory* that are most relevant to the firm's business as it exists today, including training for supervisors. Then, consider training topics prompted by new products or services the firm plans to offer, such as security futures, where training is mandated before a registered person can conduct business in this area. Other training topics may address issues raised by new rules, customer complaints, or regulatory examination findings.

In addition to the training resources listed next to each topic in the *Firm Element Advisory*, there are two additional resources on the Council Web Site (www.securitiescep.com) to assist with Firm Element requirements. The first is the *Firm Element Organizer*, an easy-to-use software application. Just identify specific investment products or services and training topics from a defined list. The *Firm Element Organizer* then searches an extensive database of training resources similar to those listed in the *Firm Element Advisory*, and provides a report of relevant resources. The report can then be edited into a Firm Element training plan using a word processing program. A tutorial on the Web Site demonstrates how to use the *Firm Element Organizer*. The second Firm Element resource comprises scenarios taken from the Regulatory Element computer-based training that may be suitable for Firm Element training. For more information, log on to www.securitiescep.com, or phone Roni Meikle, Continuing Education Manager, the New York Stock Exchange (212-656-2156), or John Linnehan, Director, NASD Continuing Education, (240-386-4684).

Training Topics and Relevant Training Points and References

Anti-Money Laundering

The SROs adopted rules, pursuant to amendments to Section 352 of USA PATRIOT Act, that every broker/dealer member must establish an anti-money laundering compliance program by April 24, 2002 that included certain specified minimum requirements:

- ♦ the development of internal policies, procedures, and controls;
- ♦ the designation of a compliance officer;
- ♦ an ongoing employee training program; and
- ♦ an independent audit function to test programs.

Anti-money laundering is an evolving topic that places additional due diligence and reporting responsibilities on firms, supervisors, and registered representatives. Many SROs and government agencies maintain Web Sites on anti-money laundering, including the SEC (www.sec.gov), the U.S. Treasury (www.ustreas.gov => *Bureaus=>Financial Crimes Enforcement Network (FinCen)*), NASD (<http://www.nasdr.com/money.asp>) and the SIA (www.sia.com => *Reference Materials => Anti-Money Laundering Guidance*). See also, *NASD Notice To Members 02-21, NASD Provides Guidance To Member Firms Concerning Anti-Money Laundering Compliance Programs Required By Federal Law*, April 2002; *NYSE Information Memoranda Nos. 02-16*, (April 12, 2002) *Anti-Money Laundering Compliance Program Requirements, 02-21* (May 6, 2002), *Approval of New Rule 445 – Anti-Money Laundering Compliance Program and 02-34* (August 1, 2002), *Special Due Diligence for Correspondent Accounts and Private Banking Account*; CBOE Rule 4.20, *Anti-Money Laundering Compliance Program*, and CBOE Regulatory Circular RG-02-69, *Anti-Money Laundering Programs*, August 19, 2002; Philadelphia Stock Exchange Rule 757 – *Anti-Money Laundering Compliance Program*.

Business Conduct

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. Broker/dealers must have supervisory procedures to make sure that they are complying with NASD Rules 3030 and 3040 regarding outside business activities and private securities transactions. Broker/dealers must also appropriately educate their associated persons regarding the requirements of Rules 3030 and 3040. 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 amendment codifies the requirement that associated persons obtain their employers' written approval prior to establishing or monitoring securities or commodities accounts or entry into private securities transactions (rather than notification) and clarifies the terms "account," "private securities transactions," and "other financial institutions."

See *NYSE Information Memo No. 02-40*, August 28, 2001, Amendments to Rule 407 Relating to Private Securities Transactions and NYSE Interpretation Memo 02-08, August 28, 2002, Interpretation to Rule 407 Transactions – Employees of Members, Member Organizations and the Exchange.

Charitable Gift Annuities

A Charitable Gift Annuity (CGA) enables an individual to transfer cash or marketable securities to charitable organizations that then issue gift annuities in exchange for a current income tax deduction and the organization's promise to make fixed annual payments for life. Registered persons may be told that CGAs do not require federal or state securities registration or licensing. This is false, however, if representatives will receive a commission.

See NASD Regulatory & Compliance Alert, *Regulatory Short Takes — Charitable Gift Annuities*, Summer 2002.

Short Term Promissory Notes

Short-term promissory notes are often marketed to registered representatives by issuers, promoters, and marketing agents who misrepresent these products as non-securities products that do not have to be sold by a broker/dealer or by a registered person. See, *NASD Notice To Members 01-79, Selling Away And Outside Business Activities, NASD Reminds Members Of Their Responsibilities Regarding Private Securities Transactions Involving Notes And Other Securities And Outside Business Activities*, December 2001.

Viatical Investments

Viatical investments are structured to provide an insured with a percentage of a life insurance death benefit before his or her death, while the investors get a share of the death benefit when the insured dies. Originated as a way to help the gravely ill pay their bills, these interests in the death benefits of terminally ill patients are always risky and sometimes fraudulent. Because of uncertainties associated with predicting an insured's death, these investments are extremely speculative, and unscrupulous promoters misrepresent or fail to disclose the risks of viatical investments.

Almost all state securities regulators consider viatical investments as securities under their respective laws, but a circuit court of appeals ruling in 1996 found that they were not securities under federal securities laws. The North American Securities Administrators

Association (NASAA) has developed Guidelines regarding viatical investments (see http://www.nasaa.org/nasaa/Files/File_Uploads/viaticalfinal.37534-67899.pdf). Broker/dealers must appropriately educate themselves and their associated persons before venturing into offering viatical investments to clients.

See also *Risky 'death futures' draw warning from state securities regulators, congressional scrutiny*; http://www.nasaa.org/nasaa/labtnasaa/display_top_story.asp?stid=245

Communications with the Public

Disclosure and Reporting Requirements — Research Analysts and Research Reports

On May 10, 2002, the SEC, in order to improve the objectivity of research and provide investors with more useful and reliable information when making investment decisions, approved new NASD Rule 2711, *Research Analysts and Research Reports*, as well as amendments to NYSE Rule 472, *Communications With The Public and Rule 351, Reporting Requirements*. Rule 2711 and the NYSE rule amendments:

- ◆ Place restrictions on relationships between a firm's investment banking department and its research department.
- ◆ Restrict review of a research report by the subject company.
- ◆ Prohibit certain forms of research analyst compensation.
- ◆ Prohibit the promise of favorable research.
- ◆ Impose Quiet or Blackout Periods.
- ◆ Restrict trading by research analysts and firms.
- ◆ Require new disclosures in research reports and public appearances.

See *NASD Notice to Members 02-39, SEC Approves Rule Governing Research Analysts' Conflicts of Interest*, July 2002; and *NYSE Information Memos re: Disclosure and Reporting Requirements Nos. 02-24*, May 20, 2002; *02-26*, June 26, 2002; and *02-30*, July 9, 2002. Included therein is a Joint Memorandum that provides interpretive guidance for NASD and NYSE rules governing research reports and analysts.

NASD also maintains a Web Site on this evolving topic that is continuously updated, see http://www.nasdr.com/analyst_guide.htm.

*Electronic
Communications
— Suitability and
Online
Communications*

In light of the dramatic increase in the use of the Internet for communication between broker/dealers and their customers, NASD has issued a Policy Statement to provide guidance concerning a firm's obligations under the NASD general suitability rule, Rule 2310, in this electronic environment.

The Policy Statement briefly discusses some of the issues created by the intersection of online activity and the suitability rule, and it provides examples of electronic communications that NASD considers to be either within or outside the definition of "recommendation" for purposes of the suitability rule. In addition, the Policy Statement sets forth guidelines to assist members in evaluating whether a particular communication could be viewed as a "recommendation," thereby triggering application of the suitability rule.

See *Notice to Members 01-23, Suitability Rule And Online Communications*, April 2001. See also *Internet Guide for Registered Representatives*, at <http://www.nasdr.com/4040.asp>.

**Customer
Accounts, Trade
and Settlement
Practices**

*Errors and
Erroneous
Transactions*

The NYSE gave notice to its members and member organizations of new NYSE Rule 407A, and amendments to NYSE Rules 134 and 411, addressing situations involving erroneous transactions and reports. In addition, there is a new requirement that all members maintain an error account, as well as a new requirement that members report to the Exchange any account in which the member has a direct or indirect financial interest or over which the member has discretionary authority.

In addition these amendments to NYSE Rules 134 and 411 and new Rule 407A dealing with erroneous transactions, erroneous reports and member account disclosure announced in *Information Memo 01-38* (November 6, 2001), gave rise to a number of questions concerning the application of these rules which the NYSE addressed in two separate *Information Memos* (Nos. 02-19 and 02-07).

The NYSE also advised its members and member organizations regarding amendments to NYSE Rule 134.40 of the requirement to report profitable error transactions.

See *NYSE Information Memoranda 01-38, Mandatory Error Account Requirement, Error Transaction Procedures, Recordkeeping Requirements, Disclosure of All Member Accounts, and Procedures for Handling Erroneous Reports/Rules 134, 407A, and 411*, November 6, 2001; 02-07, *Mandatory Error Account Requirement and Error Transaction Procedures – Rules 134, 407A and 411*, February 5, 2002; 02-10, *Rule 134.10 – Reporting Profitable Error Transactions*, March 5, 2002; and 02-19, *Errors, Erroneous Reports and Error Accounts – Rules 134, 411 and 407A*, April 29, 2002.

*Gifts and
Gratuities*

NYSE restated and reminded its members and member organizations of the Exchange's policy on gifts and gratuities which prohibits most Exchange employees from accepting gifts and gratuities from members, allied members, and member organizations. Limited exceptions are provided for Exchange Operational/Clerical Trading Floor employees who may accept usual and customary gratuities, not in excess of \$50 per year. The memo also references NYSE Rule 350 ("Compensation or Gratuities to Employees of Others").

See *NYSE Information Memo No. 01-49*, December 19, 2001, *Exchange Guidelines on Gifts and Gratuities*.

*Margin Disclosure
and Day-Trading
Risk Disclosure
Statements*

NASD has adopted amendments to (1) Rule 2341 (Margin Disclosure Statement) to require firms that permit customers to open accounts online or to engage in transactions in securities online to post the margin disclosure statement on their Web Sites and (2) NASD Rule 2362 (Day-Trading Risk Disclosure Statement) to require firms that promote a day-trading strategy to post the day-trading risk disclosure statement on their Web Sites.

See *NASD Notice to Members 02-35*, *Margin Disclosure and Day-Trading Risk Disclosure Statements*, June 2002.

Options

*AM-Settled
Index Options*

Expiring AM-settled index options should be considered exercised, assigned or purged at the point the securities that comprise the index open for trading on the business day immediately preceding Saturday expiration. In the case of an AM-settled index option carried short and treated as "covered," the writing of a new index option on Friday, after the opening to replace the assigned or expiring option, will not be deemed to constitute an "uncovered" transaction.

See *CBOE Regulatory Circular RG02-46*, *Time at Which Expiring AM-Settled Index Options are Considered Exercised, Assigned or Purged*.

*Alerting
Customers to
Adjustments
to Option
Contracts*

SROs reminded member organizations of the need to review their policies and procedures to ensure that customers are provided with relevant information concerning adjustments to option contracts as the result of corporate actions.

See *CBOE Regulatory Circular RG02-41*, *Alerting Customers to Adjustments to Options Contracts*. *NASD Notice to Members 02-17*, *Alerting Customers to Adjustments to Options Contracts*, March 2002; *NYSE Information Memo No. 02-42*, September 19, 2002, *Alerting Customers To Adjustments To Options Contracts Resulting From Corporate Actions*.

**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*.

*Disclosure of
Material Facts*

The SEC approved an interpretive notice regarding Rule G-17, on disclosure of material facts. The first prong of Rule G-17 is essentially an anti-fraud prohibition; the second prong of the rule imposes a duty on dealers to deal fairly. As part of a dealer's obligation to deal fairly, the dealer is required to disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security. These affirmative disclosure obligations apply even when a dealer is acting as an order taker and effecting non-recommended secondary market transactions.

See "Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts" (<http://www1.msrb.org/msrb1/archive/G-17NOTICE32002.htm>).

*Municipal Fund
Securities,
Including 529
Plans*

A municipal fund security (e.g., 529 Plans and local government investment pools) is defined in MSRB Rule D-12 as a municipal security issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, would constitute an investment company thereunder.

The MSRB recognizes that the market for municipal fund securities continues to evolve rapidly, particularly with respect to the 529 College Savings Plans. Many dealers active in this market have no other experience effecting municipal securities transactions and therefore may not be familiar with the rules of the MSRB. Other dealers that do have a sound understanding of MSRB rules as they relate to traditional debt securities have discovered that familiar rules are applied in unfamiliar ways due to the unique nature of municipal fund securities. All dealers are reminded that all activities in municipal fund securities are subject to MSRB rules. Dealers are required by MSRB Rule G-17 to deal fairly with all persons and that they not engage in any deceptive, dishonest, or unfair practice. In some cases, certain sales-related activities are governed by MSRB, e.g., Rule G-19, on suitability of recommendations and transactions,

Rule G-21, on advertising, and Rule G-30, on prices and commissions. Other activities may not be explicitly addressed by a specific MSRB rule; however, the general principles of Rule G-17 always apply.

The MSRB has amended Rule G-3, on professional qualifications, to provide a temporary alternative method for qualification of municipal securities principals in connection with municipal fund securities. Until March 31, 2003, a dealer may designate an investment company/variable contracts limited principal or a general securities principal to act as a municipal fund securities limited principal. A designated municipal fund securities limited principal will have all of the powers and responsibilities of a municipal securities principal under MSRB rules with respect to transactions in municipal fund securities and, under certain circumstances, may be counted toward the dealer's numerical requirement with regard to municipal securities principals.

See "Municipal Fund Securities Limited Principal Qualification Examination: Filing of Test Specifications, Study Outline and Extension of Transition Period (<http://www1.msrb.org/msrb1/archive/Series51Notice.htm>)

"Application of Fair Practice and Advertising Rules to Municipal Fund Securities" (<http://www1.msrb.org/msrb1/archive/MFS-FairPracticeNotice—5-02.htm>).

Also, see NASD's *Smart Saving for College – Better By Degrees, 529 Plans and Other Savings Options*, http://www.nasdr.com/529_saving.asp, and "Saving for Education: A Long-Term Investment Guide to Understanding 529 Plans," prepared by the College Savings Plans Network, the North American Securities Administrators Association, and the Investment Company Institute, http://www.nasaa.org/nasaa/Files/Top_Stories/529%20brochure1.37536-62599.pdf

*Political
Contributions
and Prohibitions
on Municipal
Securities Business*

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 municipal finance professional associated with such dealer, or any political action committee controlled by the dealer or any municipal finance professional. The only exception to this absolute prohibition on municipal securities business is for certain contributions made to issuer officials by municipal finance professionals, but only if the municipal finance professional is entitled to vote for such official and provided any contributions do not exceed, in total, \$250 to each official, per election. Dealers must report certain information about political contributions, political party payments, municipal securities business, and consultants to the MSRB on Form G-37/G-38 or, if appropriate, dealers may file a Form G-37x with the MSRB.

The definition of “municipal finance professional” includes any associated person of the dealer who solicits municipal securities business. “Associated person” is defined in Section 3(a)(18) of the Securities Exchange Act of 1934. See SEC order *In the Matter of Fifth Third Securities, Inc.*, Exchange Act Release No. 46087, June 18, 2002; MSRB Rule G-37: Political Contributions and Prohibitions on Municipal Securities Business, *MSRB Rule Book*.

*Transactions in
Securities with
Minimum
Denominations*

Dealers are prohibited from effecting transactions with customers in below-minimum denomination amounts for securities issued after June 1, 2002. There are two limited exceptions to this rule. First, dealers may purchase a below-minimum denomination position from a customer provided that the customer liquidates his or her entire position. Second, dealers may sell such a liquidated position to another customer but would be required to provide written disclosure, either on the confirmation or separately, to the effect that the security position is below the minimum denomination and that liquidity may be adversely affected by this fact. The MSRB issued an interpretation of Rule G-17, on fair practice, that states that any time a dealer is selling to a customer a quantity of municipal securities below the minimum denomination for the issue, the dealer should consider this to be a material fact about the transaction. The MSRB believes that a dealer’s failure to disclose such a material fact to the customer, and to explain how this could affect the liquidity of the customer’s position, generally would constitute a violation of the dealer’s duty under Rule G-17 to disclose all material facts about the transaction to the customer.

See “Approval of Amendments Concerning Minimum Denominations” (<http://www1.msrb.org/msrb1/archive/approvalnotice.htm>).

*Transactions with
Sophisticated
Municipal Market
Professionals*

The SEC approved an interpretive notice concerning the application of MSRB rules to transactions with sophisticated municipal market professionals (“SMMP”). An institutional customer can be considered an SMMP if the dealer has reasonable grounds for concluding that the customer (i) has timely access to the to all publicly available material facts concerning a municipal securities transaction; (ii) is capable of independently evaluating the investment risk and market value of the municipal securities at issue; and, (iii) is making independent investment decisions about its investment in municipal securities. The notice addresses the manner in which a dealer has determined that it has met its fair practice obligations to certain institutional customers; it does not alter the basic duty of the dealer to deal fairly in all transactions and with all customers.

See "Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals" (<http://www1.msrb.org/msrb1/archive/SMMPAPPROVAL0502.htm>).

Registration and Reporting Requirements

Reportable Criminal Offenses

The NYSE narrowed the scope of reportable criminal offenses to incidents which are more germane to the conduct of a securities-related business minimizing the number of less material filings and maximizing the efficient use of resources committed to fulfilling self-regulatory responsibilities at both the Exchange and member organizations. The rule amendment captures the reporting of arrests for which any subsequent conviction or plea of no contest or guilty, would subject the individual to a statutory disqualification from securities industry employment or association.

See *NYSE Information Memo No. 02-31, Update Regarding Exchange Rule 351 – Reporting Requirements*, July 15, 2002, and *NYSE Information Memo No. 02-29, Exchange Rule 351 – Reporting Requirements*, July 8, 2002.

Registration and Reporting

Trading Floor

The NYSE has prepared an Information Memo that outlines requirements for conducting a public business from the Floor. Registration topics addressed include the distinction between dealing with the "public" as distinguished from "professional customers"; the registration requirements of sole proprietors; and the registration, disclosure, and supervisory requirements specifically applicable to dual employees.

A general outline is included that references several prerequisites for conducting a public business including supervisory requirements, state registration, capital requirements, fidelity bond coverage, documentation requirements, and carrying agreements. The Memo also outlines policies and procedures related to permissible and restricted means of telephonic/electronic means of Floor communications.

See *NYSE Information Memo No. 01-41*, November 21, 2001, *Conducting a Public Business on the Floor*.

Security Futures (also known as Single Stock Futures)

The Commodity Futures Modernization Act lifted the ban on the trading of security futures (i.e., futures on narrow-based indices, single stocks, and options on security 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 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 security 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.

Firms may develop their own security 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 <http://www.nasdr.com/futures.asp>.

Finally, members are reminded of the 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.

Please monitor the following SRO Web Sites as well as the NASD Web Site above for additional information:

<http://www.nqlx.com>

<http://www.onechicago.com>

<http://www.nfa.futures.org>

<http://www.cboe.com>

<http://www.nyse.com>

<http://www.amextrader.com>

Supervision

Books and Records

Branch office managers and other supervisory personnel 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 become effective on May 2, 2003. The amendments clarify and expand record-keeping 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 changes to 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.

For more information, see *Amendments To Broker/Dealer Books And Records Rules Under The Securities Exchange Act Of 1934*, NASD Notice to Members 01-80, December 2001, <http://www.nasdr.com/pdf-text/0180ntm.pdf>.

Supervision

General Topics

Industry SRO 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, such as security futures, 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
- ◆ Failing to respond to SRO information requests
- ◆ Failing to take advantage of mutual fund discounts

-
- ♦ Falsifying documents
 - ♦ Forgery
 - ♦ Misrepresentations to customers
 - ♦ Selling away
 - ♦ Unsuitable recommendations
 - ♦ Unauthorized trading

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 http://www.nasdr.com/disc_update_index.asp, and the NYSE's Disciplinary Actions at <http://www.nyse.com/regulation/regulation.html>.

Variable Annuities

Bonus Annuities

Bonus annuities offer credits equal to a percentage of the amount invested in the variable annuity contract. The investment is usually from a 1031 exchange from another variable annuity contract. Bonus credits generally range from 3 percent to 5 percent of the money invested. In order to fund these bonus credits, the bonus contracts typically impose high mortality and expense charges and lengthy surrender charge periods. Registered persons recommending bonus annuities must be careful to comply with applicable SRO suitability rules. Communications promoting bonus annuities must disclose fees, expenses and surrender periods with the same prominence as the bonus feature of the new variable annuity contract.

See *NASD Regulation Cautions Firms For Deficient Variable Annuity Communications, Regulatory & Compliance Alert, Spring 2002* (http://www.nasdr.com/lrca_spring02_adv.htm); *Advertising Of Bonus Credit Variable Annuities, Regulatory & Compliance Alert, Summer 2000* (http://www.nasdr.com/lrca_summer00.htm); and the NASD Regulation Investor Alert on exchanging variable annuities (http://www.nasdr.com/alert_02-01.htm)

See also:

- ♦ *Notice to Members 99-35, The NASD Reminds Members Of Their Responsibilities Regarding The Sale Of Variable Annuities, May 1999, (<http://www.nasdr.com/pdf-text/9935ntm.pdf>).*

To Obtain More Information

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

Self-Regulatory Organization	Address and Phone Number	On-line Address
American Stock Exchange	American Stock Exchange Marketing Department 86 Trinity Place New York, NY 10006 800-THE-AMEX	www.amex.com www.amextrader.com
Chicago Board Options Exchange	Chicago Board Options Exchange 400 S. LaSalle Street Chicago, IL 60605 877-843-2263 e-mail: help@cboe.com	www.cboe.com
Municipal Securities Rulemaking Board MSRB	Publications Department 1900 Duke Street Suite 600 Alexandria, VA 22314 703-797-6600	www.msrb.org
NASD	NASD MediaSource P.O. Box 9403 Gaithersburg, MD 20898-9403 301-590-6142	www.nasd.com
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	www.nyse.com
Philadelphia Stock Exchange	Philadelphia Stock Exchange Marketing Department 1900 Market Street Philadelphia, PA 19103 800-THE PHLX, or 215-496-5158	www.phlx.com or info@phlx.com