

INFORMATIONAL

Continuing Education

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

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Continuing Education
- Legal & Compliance
- Registration
- Senior Management

KEY TOPICS

- Continuing Education
- Firm Element

Executive Summary

The Securities Industry/Regulatory Council on Continuing Education (Council) has issued a *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 October 2000. 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 a firm 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 listing relevant resources sorted by investment product or service. A firm can use a word processing program to edit the report that can help create a written Firm Element plan. The second resource comprises scenarios from the Regulatory Element computer-based training, which 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, Continuing Education, NASD Regulation, Inc., at (240) 386-4684.

Background

The Council includes 14 members representing a cross-section of securities firms and six SROs.¹ Both the Securities and Exchange Commission and the North American Securities Administrators Association have appointed liaisons to the Council.

The Council facilitates industry/regulatory coordination of the administration and future development of the Continuing Education Program. Council responsibilities also include recommending and helping to develop specific content and questions for the Regulatory Element programs and minimum core curricula for the Firm Element.

Endnotes

- 1 The American Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the Municipal Securities Rulemaking Board, the National Association of Securities Dealers, Inc., the New York Stock Exchange, Inc., and the Philadelphia Stock Exchange, Inc. are members of the Council.

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The Securities Industry Continuing Education Program

The 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 October 2000.

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 Firm Element 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. Once the firm has identified and prioritized training topics, it should review the training resources listed in the *Firm Element Advisory*. Remember that any training topics included in the firm's written training plan should be relevant to the firm's unique situation and implementation of the plan should be appropriate to the firm's size and structure.

The Council now 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 a firm 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 listing relevant resources sorted by investment product or service. A firm can use a word processing program to edit the report that can help create a written Firm Element plan. The second resource comprises scenarios from the Regulatory Element computer-based training, which 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, or phone Roni Miekle, Continuing Education Manager, the New York Stock Exchange (212-656-2156), or John Linnehan, Director, Continuing Education, NASD Regulation, Inc. (240-386-4684).

Training Topic	Relevant Training Points and References
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<p>Certificates of Deposit (CDs)</p>	<p>The New York Stock Exchange (NYSE) reminded its member organizations that the risks associated with Long-Term CDs must be disclosed to prospective purchasers. In addition, the NYSE advised its members that after September 2001, par pricing may not be utilized on statements for Long-Term CDs and if market value is not provided, Long-Term CD positions must be reflected on customer statements as unpriced.</p> <p>See NYSE Information Memo Nos. 01-05 and 01-19, “<i>Long-Term Certificates of Deposit Sales Practice</i>,” March 7, 2001 and July 20, 2001, respectively.</p>
<p>Communications with the Public</p> <p>Electronic Communications— Stock Spams and Scams</p>	<p>NASD Regulation has published <i>Stock Spams and Scams</i>, an <i>Investor Alert</i> on junk e-mail communications about investing in stock. See http://www.nasdr.com/alert_05-01.htm.</p>
<p>Communications with the Public</p> <p>Electronic Communications— Suitability and Online Communications</p>	<p>In light of the dramatic increase in the use of the Internet for communication between broker/dealers and their customers, NASD Regulation issued a Policy Statement to provide guidance concerning a firm’s obligations under the NASD general suitability rule, Rule 2310, in this electronic environment.</p> <p>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 Regulation 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.</p> <p>See <i>NASD Notice to Members 01-23, Suitability Rule And Online Communications</i>, April 2001.</p>

**Customer Accounts,
Trade and Settlement
Practices**

Customer Account
Transfer Contracts

Recent modifications to the Automated Customer Account Transfer Service (ACATS) provide the capability to facilitate the transfer of accounts containing third-party and “in-house” proprietary products, including mutual funds. The NYSE approved amendments to an Interpretation of NYSE Rule 412 (Customer Account Transfer Contracts). The amendments are intended to expedite the transfer of accounts containing such products, as well as clarifying the responsibilities of a carrying organization when transferring accounts that have been internally reassigned, with new account numbers, to another registered representative. The amendments become effective January 28, 2002.

See NYSE Information Memo No. 01-23, *Amendments to the Interpretation of Rule 412 (“Customer Account Transfer Contracts”)*, August 16, 2001.

**Customer Accounts,
Trade and Settlement
Practices**

Direct Registration
System (DRS)

The Securities and Exchange Commission (SEC) views DRS as a very important component of the move to T+1 and of the continuing effort to immobilize the movement of physical certificates. DRS allows a shareholder to have securities registered electronically in the shareholder’s name directly on the books of the issuer or its transfer agent without the need for a physical certificate to evidence ownership. The use of DRS also enables a shareholder to electronically move a shareholder’s securities from a directly registered position on the books of an issuer or its transfer agent to a street-name position in the shareholder’s broker/dealer’s account at the Depository Trust Company, and vice-versa. As more issuers choose to make their securities eligible for DRS and more investors seek to take advantage of it, it is imperative that affected registered persons be aware of DRS.

For more information on DRS, see SEC Release No. 34-44696, “Order Relating to the Movement of All DRS Issues into Profile,” dated August 14, 2001, and also the Web Sites for the SEC Division of Market Regulation (<http://www.sec.gov/divisions/marketreg.shtml>), the Depository Trust Company (<http://www.dtc.org>), and the Securities Industry Association (<http://www.sia.com>).

**Customer Accounts,
Trade and Settlement
Practices**

NASD Three Quote
Rule

On September 21, 2000, the SEC approved amendments to NASD Rules 2320(g) (Best Execution and Interpositioning) and 3110(b) (Books and Records – Marking of Order Tickets).

The amendments to Rule 2320(g) require members to obtain quotations from three dealers (or all dealers if three or fewer) only when there are fewer than two priced quotations displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis (such as the OTCBB or the electronic pink sheets).

Under the amendments to Rule 3110(b)(2), members are no longer required to indicate on the order ticket for each transaction in a non-Nasdaq security the name of each dealer contacted and the quotations received to determine the best inter-dealer market whenever two or more priced quotations are displayed in an inter-dealer quotation system and NASD Regulation has access to the quotation data.

See NASD Notice to Members 00-78, SEC Approves Proposed Changes To The NASD Three Quote Rule And Related Recordkeeping Requirements, November 2000.

**Customer Accounts,
Trade and Settlement
Practices**

NYSE Rule 80A Collars
and NYSE Rule 80B
Circuit Breaker Levels

NYSE Rule 80A (Index Arbitrage Trading Restrictions) addresses the change in the Dow Jones Industrial Average that triggers the rule's tick restrictions.

NYSE Rule 80B (Trading Halts Due To Extraordinary Market Volatility) addresses halt provisions and circuit breaker levels.

The NYSE changes the trading collars and circuit breaker levels on a quarterly basis.

See NYSE Information Memo Nos. 00-32, 01-08, and 01-15, "New Rule 80A Collars and Rule 80B Circuit Breaker Levels", December 29, 2000, April 2, 2001, and July 2, 2001.

Training Topic	Relevant Training Points and References
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<p>Customer Accounts, Trade and Settlement Practices</p> <p>Options</p> <p>Order Entry</p> <p>Prohibition Against Electronically Generated Orders</p>	<p>The SEC on September 12, 2000, approved Chicago Board Options Exchange (CBOE) Rule 6.8A, <i>Electronically Generated and Communicated Orders</i>. Rule 6.8A restricts the entry of certain options orders that are created and communicated electronically without having been reviewed by the firm.</p> <p>See <i>CBOE Regulatory Circular RG00-139</i>.</p>
<p>Customer Accounts, Trade and Settlement Practices</p> <p>Options</p> <p>Prohibition Against Entering RAES Orders within 15 Seconds in the Same Option Class</p>	<p>The SEC on March 26, 2001, approved changes to CBOE Rule 6.8, RAES Operations. Changes to Rule 6.8 include the requirements imposed by paragraph (e) which require member organizations that are able to route orders to the Exchange's Order Routing System to:</p> <ul style="list-style-type: none"> ● provide written notice to all users regarding the proper use of RAES, and ● not enter or cause the entry of multiple orders in the same option class within any 15-second period for an account or the accounts of the same beneficial owner. <p>See <i>CBOE Regulatory Circular RG01-41</i>.</p>
<p>Customer Accounts, Trade and Settlement Practices</p> <p>Regulation S-P</p>	<p>Regulation S-P (effective July 1, 2001) requires financial institutions to provide notice to consumers about the institution's privacy policy and practice, restricts the ability of financial institutions to share non-public personal information about consumers with non-affiliated third parties, and allows consumers to prevent such information sharing by "opting out." It also requires the safeguarding of customer information by firms.</p> <p>See <i>NASD Regulatory & Compliance Alert</i>, Summer 2001 (http://www.nasdr.com/rca_summer01.htm), and NYSE Information Memo No. 01-10, "Regulation S-P," June 19, 2001.</p>

Training Topic	Relevant Training Points and References
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<p>Individual Retirement Accounts</p> <p>“Stretch” IRAs</p>	<p>In response to Internal Revenue Service rule changes that created a variation on traditional IRAs, NASD Regulation published an <i>Investor Alert</i> on “Stretch” IRAs. Sales presentations for stretch IRAs usually include value tables that give hypothetical examples showing how much the IRA account will be worth over time, sometimes for periods up to 90 years. Investors should realize that the huge values contained in the sales presentations depend on assumptions that can change and greatly reduce the projected value of the IRA.</p> <p>See “<i>Stretch IRAs - Too Much of a Stretch for You?</i>,” http://www.nasdr.com/alert_07-01.htm.</p>
<p>Margin</p>	<p>NASD Regulation has published a number of communications for members, investors, and others about margin-related topics. Please see http://www.nasdr.com/5700.htm for more information.</p>
<p>Margin</p> <p>Day-Trading Margin Requirements</p>	<p>The SEC approved amendments establishing new minimum equity requirements to address the risks associated with day trading in customer accounts. Among other things, the amendments require that equity and maintenance margin be deposited and maintained in customer accounts that engage in a pattern of day trading. In addition, the amendments define the term “pattern day-trader” and establish minimum equity requirements of \$25,000 for pattern day-traders.</p> <p>See <i>NASD Notice to Members 01-26, SEC Approves Proposed Rule Change Relating To Day-Trading Margin Requirements</i>, April 2001, and <i>NYSE Information Memo 01-09, Amendments to Rule 431 (“Margin Requirements”)</i>, April 2, 2001.</p>

Training Topic	Relevant Training Points and References
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Margin

Margin Disclosure Statement to Non-Institutional Customers

On April 26, 2001, the SEC approved NASD Rule 2341, which requires all NASD members to deliver to retail customers a specified disclosure statement that discusses the operation of margin accounts and the risks associated with trading on margin.

See *NASD Notice to Members 01-31, SEC Approves NASD Rule Proposal Requiring Delivery Of Margin Disclosure Statement To Non-Institutional Customers*, May 2001, and *NASD Notice to Members 01-37, NASD Regulation Extends Deadline For Delivery Of Margin Disclosure Statement To Existing Non-Institutional Customers To January 31, 2002*, June 2001.

Municipal Securities

Municipal Fund Securities, Including 529 Plans

A municipal fund security (e.g., 529 Plans and local government investment pools) is defined in Municipal Securities Rulemaking Board (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 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 July 31, 2002, 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 "Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market," January 18, 2001, *MSRB Rule Book* (July 1, 2001) at 14; "Municipal Fund Securities-Qualification of Municipal Securities Principals and Application of MSRB Rules to Fees, Disclosure and Other Market Practices," MSRB Reports, Vol. 21, No. 2 (July 2001) (<http://www.msrb.org/msrb1/reports/0701v212/MFS.htm>).

Municipal Securities

Delivery of Official Statements to Customers and Other Dealers

During the underwriting period, a dealer is prohibited from selling new issue municipal securities (other than commercial paper) to a customer unless the dealer delivers to the customer by settlement of the transaction a copy of the final official statement if one is prepared by or on behalf of the issuer. If a municipal securities issuer will prepare only a preliminary official statement and not a final official statement, a dealer must deliver the preliminary version along with a written notice to customers that no final official statement will be prepared.

See MSRB Rule G-32: Disclosures in Connection with New Issues, *MSRB Rule Book*.

Municipal Securities

Delivery of Official Statements and Advance Refunding Documents to the MSRB

Managing underwriters are required to deliver to the MSRB, among other things, copies of final official statements for most primary offerings of municipal securities, if such documents are prepared by or on behalf of the municipal securities issuer. For refunding issues, dealers must send to the MSRB two copies of the refunding escrow agreement, or its equivalent, if prepared by or on behalf of the municipal securities issuer. Dealers must send these documents to the MSRB using the appropriate form.

Effective January 1, 2002, underwriters may begin making submissions in electronic form. See MSRB Rule G-36: Delivery of Official Statements, Advance Refunding Documents and Forms G-36(OS) and G-36(ARD) to Board or its Designee, *MSRB Rule Book*; *Form G-36 Manual* published by the MSRB; "SEC Approval of Electronic Submission System under Rule G 36" (<http://www.msrb.org/msrb1/whatsnew/Esubmissionapproval.htm>).

Municipal Securities

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 by such municipal finance professional 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.

See MSRB Rule G-37: Political Contributions and Prohibitions on Municipal Securities Business, *MSRB Rule Book*.

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*; "Bank Affiliates as Municipal Finance Professionals or Consultants," *MSRB Rule Book* (July 1, 2001) at 239.

Training Topic	Relevant Training Points and References
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<p>Municipal Securities</p> <p>Flat Transaction Fees</p>	<p>The MSRB has issued a notice concerning dealers that will charge a flat transaction fee of \$15.00 for trades executed through an automated trading system. Since this fee is relatively small and unrelated to the par value of the transaction, the MSRB believes that the transaction fee should be considered a miscellaneous transaction fee. Therefore, the fee would not have to be incorporated into the stated yield, but would need to be separately disclosed on the confirmation.</p> <p>See "Notice Concerning Flat Transaction Fees," June 13, 2001, <i>MSRB Rule Book</i> (July 1, 2001) at 114.</p>
<p>Mutual Funds</p> <p>Understanding Mutual Fund Classes</p>	<p>NASD Regulation has published an <i>Investor Alert</i> on the subject of mutual fund classes. See http://www.nasdr.com/alert_12-02.htm.</p>
<p>Performance Fees</p>	<p>On February 15, 2001, the SEC approved amendments to NASD Rule 2330(f)(2) to permit NASD members and associated persons that act as investment advisers to share in the customer account profits and gains, subject to the provisions of Rule 205-3 under the Investment Advisers Act of 1940.</p> <p>See <i>NASD Notice to Members 01-24, SEC Approves Proposed Changes To Rule 2330(f)(2) Relating To Performance Fees</i>, April 2001.</p>
<p>Promissory Notes</p>	<p>A brochure, produced jointly by the North American Securities Administrators Association (NASAA), NASD, SEC, and SIA outlines the risks and rewards of investing in promissory notes. Investors learn what to consider in evaluating whether promissory notes are sound investments. Concrete examples illustrate the kinds of scams that have cost some investors their life savings. See http://www.sia.com/publications/html/promissory_notes_brochure.html, and also <i>Promissory Notes Can Be Less Than Promised</i>, an <i>Investor Alert</i> published by NASD Regulation at http://www.nasdr.com/alert_12-01.htm.</p>

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

The Commodity Futures Modernization Act of 2000 amended the Securities Act of 1933, the Securities and Exchange Act of 1934, and the Commodity Exchange Act of 1936 to permit the trading of “security futures (also known as Single Stock Futures)”: futures on individual stocks and narrow-based indexes. This statutory change removes the ban on U.S. futures trading on an array of equity securities and securities indexes that has been in place since 1982. The introduction of security futures is expected to begin December 21, 2001.

Because security futures will have different characteristics and requirements than existing securities, industry SROs are requiring that each registered person complete a Firm Element continuing education program on security futures before he or she can conduct a public business in security futures.

Please monitor the following SRO Web Sites for information about security futures and training requirements.

- American Stock Exchange: <http://www.amextrader.com>
- Chicago Board Options Exchange:
<http://www.cboe.com/Institutional/SingleStockFutures.asp>
- NASD Regulation: <http://www.nasdr.com>
- New York Stock Exchange: <http://www.nyse.com>
- Philadelphia Stock Exchange: <http://www.phlx.com>

Supervision

Compensation of
Members and Dual
Employment as Relates
to Floor Activities

The NYSE identified, clarified, and emphasized three areas for its members and member organizations: (1) employment, compensation, and dual employment of members, (2) the appropriate type of agreement for a member executing transactions with public customers, and (3) direct access business.

See NYSE Information Memo No. 01-18, *“I. Compensation of Members and Dual Employment, II. Executing Broker Arrangements, III. Direct Access,”* July 11, 2001.

Also see PHLX Memorandum 93-14 and related Equity Floor Procedures Advice.

<p>Variable Contracts</p> <p>Exchanges of Variable Annuities</p>	<p>NASD Regulation has published an <i>Investor Alert</i> on exchanging variable annuities. See http://www.nasdr.com/alert_02-01.htm</p> <p>See also:</p> <ul style="list-style-type: none"> ● <i>NASD Notice to Members 99-35, The NASD Reminds Members Of Their Responsibilities Regarding The Sale Of Variable Annuities</i>, May 1999. ● Variable Annuities: What You Should Know at www.sec.gov/consumer/varannty.htm ● <i>NASD Regulatory & Compliance Alert, Advertising Of Bonus Variable Annuities</i>, Summer 2000. (http://www.nasdr.com/rca_summer00.htm).
<p>Variable Contracts</p> <p>Sales of Variable Life Insurance</p>	<p>Variable life insurance and variable annuity contracts (Variable Contracts) are securities, and accordingly, their distribution is subject to industry rules. Of particular importance are:</p> <ul style="list-style-type: none"> ● NASD Rule 3010 (Supervision), which requires each member to establish and maintain systems to supervise the activities of each registered representative and associated person in order to achieve compliance with the securities laws, regulations, and rules; and ● NASD Rule 2310 (Suitability), which requires that a member, when recommending the purchase, sale, or exchange of any security to a customer, have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts disclosed by the customer. <p>See <i>NASD Notice to Members 00-44, The NASD Reminds Members Of Their Responsibilities Regarding The Sale Of Variable Life Insurance</i>, July 2000. [This <i>Notice</i> focuses on retail sales of variable life insurance, including both scheduled premium and flexible premium products, and provides a set of guidelines to assist members in developing sales-related supervisory procedures.]</p>

TO OBTAIN MORE INFORMATION

Organization Address	Phone Number	Online Address
American Stock Exchange	American Stock Exchange Marketing Department 86 Trinity Place New York, NY 10006 800-THE-AMEX	http://www.amex.com http://www.amextrader.com
Chicago Board Options Exchange	Investor Services Chicago Board Options Exchange 400 S. LaSalle Street Chicago, IL 60605 800-OPTIONS	http://www.cboe.com
Municipal Securities Rulemaking Board	MSRB Publications Department 1900 Duke Street Suite 600 Alexandria, VA 22314 703-797-6600	http://www.msrb.org
National Association of Securities Dealers	NASD MediaSource P.O. Box 9403 Gaithersburg, MD 20898-9403 240-386-4200	http://www.nasdr.com
New York Stock Exchange	New York Stock Exchange Publications Department 11 Wall Street, 18th Floor New York, NY 10005 212-656-5273 212-656-2089	http://www.nyse.com
Philadelphia Stock Exchange	Philadelphia Stock Exchange Marketing Department 1900 Market Street Philadelphia, PA 19103 800-THE PHLX 215-496-5158	http://www.phlx.com info@phlx.com
Securities Industry/Regulatory Council on Continuing Education		http://www.securitiescep.com