

NASD Notice to Members 98-59

SEC Approves Amendments To NASD Rule 1120 (Continuing Education Requirements)

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Executive Summary

The Securities and Exchange Commission (SEC) recently approved amendments to National Association of Securities Dealers, Inc. (NASD[®]) Rule 1120 relating to Continuing Education requirements (see SEC Release No. 34-39712, dated March 3, 1998, and File No. SR-NASD-98-03). The text of amended Rule 1120 is included in this *Notice*. The rule changes are effective as of July 1, 1998.

Any questions relating to this *Notice* should be directed to John Linnehan, Director, Continuing Education, NASD Regulation, Inc., at (301) 208-2932 or Daniel M. Sibears, Vice President, District Oversight, NASD RegulationSM at (202) 728-6911.

Background

NASD Rule 1120 (the Rule) provides for a Continuing Education Program for registered persons of NASD members. The Program, which is uniform within the industry, consists of two parts - a Regulatory Element and a Firm Element. The Regulatory Element requires all registered persons to periodically complete a computer-based training program on compliance, ethical, sales practice, and regulatory matters. The Firm Element requires members to provide ongoing training specifically tailored to their business.

New Cycle For Participation In The Regulatory Element

The time frames for registered persons to participate in the Regulatory Element training have been revised. The Rule now requires ongoing participation in the Program by registered persons throughout their securities industry careers. Specifically, participation in the Regulatory Element is required within 120 days of the second anniversary of initial registration and every three years

thereafter (*i.e.*, the fifth, eighth, 11th, 14th, etc., anniversaries), with no graduation from the program. Incurring a significant disciplinary action will result in an immediate requirement to complete the Regulatory Element within 120 days of the effective date of the significant disciplinary action. The cycle for participation in the Regulatory Element will then be reset based on the effective date of the significant disciplinary action rather than on the initial securities registration date.

Formerly, the Rule required registered persons to complete the Regulatory Element computer-based training on just three occasions, *i.e.*, within 120 days of their second, fifth, and 10th anniversaries of initial registration (and also when they were the subject of significant disciplinary action), with graduation once persons were registered for more than 10 years.

Graduates From The Regulatory Element And Persons Registered In A Principal Category

The Rule allows an exception from the Regulatory Element participation for persons currently graduated from the Program. Those persons who have been registered for more than 10 years as of the effective date of the rule amendments (*i.e.*, July 1, 1998), and who have not been the subject of significant disciplinary action during the preceding 10 years, will be excluded from the mandatory participation in the Regulatory Element. However, in order for persons registered in a principal capacity to be excluded from the Regulatory Element, they must have been registered in a principal capacity for more than 10 years. Therefore, those principals who have graduated from the Regulatory Element based on their initial registration date, but who have not completed 10 years as a princi-

pal, are required to re-enter the Program.

New Program For Principals

The Regulatory Element program applies generally to all registered persons and, as originally adopted, did not discern between registration types or categories. The Rule now allows the NASD, when appropriate, to designate specific Regulatory Element programs for various registration categories, thereby providing customized training for such categories. The first initiative will be a principal's program which will be announced and implemented in the near future. Principals must continue to take the current Regulatory Element program until implementation of the new principal's program. In the future, specific programs may be implemented for other registration categories.

For purposes of NASD rules, the following registrations will be included in the principal category: Series 4 (Registered Options Principal); Series 8 (General Securities Sales Supervisor); Series 26 (Investment Company Products/Variable Contracts Limited Principal); Series 27 (Financial and Operations Principal); Series 28 (Introducing Broker-Dealer Financial and Operational Principal); Series 39 (Direct Participation Programs Principal); Series 53 (Municipal Securities Principal Qualification); and the Government Securities Principal (no series number).

Firm Element

The Firm Element requires that each member conduct an annual analysis of their training needs. Members must also administer appropriate training to their registered persons who have direct contact with customers and the immediate supervisors of such registered persons, on an ongoing basis. The training must

cover topics specifically related to their business, such as new products, sales practices, risk disclosure, and new regulatory requirements and concerns.

The Rule requires members to focus specifically on supervisory needs in their analysis and, if it is determined that supervisory training is necessary, it must be addressed in the Firm Element training plan.

Amended NASD Membership and Registration Rule 1120

(Note: New text is underlined; deletions are bracketed.)

1120. Continuing Education Requirements

This Rule prescribes requirements regarding the continuing education of certain registered persons subsequent to their initial qualification and registration with the Association. The requirements shall consist of a Regulatory Element and a Firm Element as set forth below.

(a) Regulatory Element

(1) Requirements

No member shall permit any registered person to continue to, and no registered person shall continue to, perform duties as a registered person unless such person has complied with the requirements of paragraph (a) hereof.

(A) Each registered person shall complete the Regulatory Element on [three occasions, after] the occurrence of their second[, fifth and tenth] registration anniversary [dates] date and every three years thereafter, or as otherwise prescribed by the Association. On each [of three occasions] occasion, the Regulatory Element must be completed within [one hundred twenty] 120 days after the per-

son's registration anniversary date. A person's initial registration date shall establish the cycle of anniversary dates for purposes of this Rule. The content of the Regulatory Element shall be [prescribed by the Association] determined by the Association and shall be appropriate to either the registered representative or principal status of person subject to the Rule.

(B) Persons Exempted from the Rule - [Registered persons] Persons who have been continuously registered for more than 10 years [as of the effective date of this Rule] on July 1, 1998, shall be exempt from participation in the Regulatory Element programs for registered representatives, provided such persons have not been subject within the last ten years to any disciplinary action [within the last 10 years] as enumerated in paragraph (a)(3). A person who has been continuously registered as a principal for more than ten years on July 1, 1998, shall be exempt from participation in the Regulatory Element programs for registered principals, provided such person has not been subject within the last ten years to any disciplinary action as enumerated in paragraph (a)(3). In the event [of such disciplinary action,] that a [person] registered representative or principal who was exempt from participation in Regulatory Element programs subsequently becomes the subject of a disciplinary action as enumerated in paragraph (a)(3), such person shall [will] be required to satisfy the requirements of the Regulatory Element [by participation for the period from the effective date of this Rule to 10 years after the occurrence of the disciplinary action] as if the date of such disciplinary action is such person's initial registration date with the Association.

(C) Persons who have been currently registered for 10 years or less as of [the effective date of this Rule]

July 1, 1998, shall [initially] participate in the Regulatory Element within 120 days after the occurrence of the second[, fifth or tenth] registration anniversary date, or every third year thereafter, whichever anniversary date first applies[, and on the applicable registration anniversary date(s) thereafter. Such persons will have satisfied the requirements of the Regulatory Element after participation on the tenth registration anniversary].

[(D) All registered persons who have satisfied the requirements of the Regulatory Element shall be exempt from further participation in the Regulatory Element subject to re-entry into the program as set forth in paragraph (a)(3).]

(2) Failure to Complete

Unless otherwise determined by the Association, any registered persons who have not completed the Regulatory Element within the prescribed time frames will have their registrations deemed inactive until such time as the requirements of the program have been satisfied. Any person whose registration has been deemed inactive under this Rule shall cease all activities as a registered person and is prohibited from performing any duties and functioning in any capacity requiring registration. A registration that is inactive for a period of two years will be administratively terminated. A person whose registration is so terminated may reactivate the registration only by reapplying for registration and meeting the qualification requirements of the applicable provisions of the Rule 1020 Series and the Rule 1030 Series. The Association may, upon application and a showing of good cause, allow for additional time for a registered person to satisfy the program requirements.

(3) Re-entry into Program

Unless otherwise determined by the Association, a registered person will be required to re-enter the Regulatory Element and satisfy all of its requirements in the event such person:

(A) is subject to any statutory disqualification as defined in Section 3(a)(39) of the Act;

(B) is subject to suspension or to the imposition of a fine of \$5,000 or more for violation of any provision of any securities law or regulation, or any agreement with or rule or standard of conduct of any securities governmental agency, securities self-regulatory organization, or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding; or

(C) is ordered as a sanction in a disciplinary action to re-enter the continuing education program by any securities governmental agency or self-regulatory organization.

Re-entry shall commence with initial participation within 120 days of the registered person becoming subject to the statutory disqualification, in the case of (A) above, or the disciplinary action becoming final, in the case of (B) and (C) above[, and on three additional occasions thereafter, at intervals of two, five and 10 years after re-entry, notwithstanding that such person has completed all or part of the program requirements based on length of time as a registered person or completion of ten years of participation in the program]. The date of the disciplinary action shall be treated as such person's initial registration date with the Association.

(4) Reassociation in a Registered Capacity

Any registered person who has terminated association with a member

and who has, within two years of the date of termination, become reassociated in a registered capacity with a member shall participate in the Regulatory Element at such intervals [(two, five and 10 years)] that may apply (second anniversary and every three years thereafter) based on the initial registration anniversary date rather than based on the date of reassociation in a registered capacity.

(5) Definition of Registered Person

For purposes of this Rule, the term "registered person" means any person registered with the Association as a representative, principal, or assistant representative pursuant to the Rule 1020, 1030, 1040, and 1110 Series.

(b) Firm Element

(1) Persons Subject to the Firm Element

The requirements of this subparagraph shall apply to any person registered with a member who has direct contact with customers in the conduct of the member's securities sales, trading and investment banking activities, and to the immediate supervisors of such persons (collectively, "covered registered persons"). "Customer" shall mean any natural person and any organization, other than another broker or dealer, executing securities transactions with or through or receiving investment banking services from a member.

(2) Standards for the Firm Element

(A) Each member must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skill, and professionalism. At a minimum, each member shall at least annually evaluate and prioritize its training needs and develop a written training plan. The plan

must take into consideration the member's size, organizational structure, and scope of business activities, as well as regulatory developments and the performance of covered registered persons in the Regulatory Element. If a member's analysis establishes the need for supervisory training for persons with supervisory responsibilities, such training must be included in the member's training plan.

(B) Minimum Standards for Training Programs - Programs used to implement a member's training plan must be appropriate for the business of the member and, at a minimum must cover the following matters concerning securities products, services, and strategies offered by the member:

(i) General investment features and

associated risk factors;

(ii) Suitability and sales practice considerations; and

(iii) Applicable regulatory requirements.

(C) Administration of Continuing Education Program - A member must administer its continuing education programs in accordance with its annual evaluation and written plan and must maintain records documenting the content of the programs and completion of the programs by covered registered persons.

(3) Participation in the Firm Element

Covered registered persons included in a member's plan must take all appropriate and reasonable steps to

participate in continuing education programs as required by the member.

(4) Specific Training Requirements

The Association may require a member, individually or as part of a larger group, to provide specific training to its covered registered persons in such areas as the Association deems appropriate. Such a requirement may stipulate the class of covered registered persons for which it is applicable, the time period in which the requirement must be satisfied, and, where appropriate, the actual training content.

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