

Notice to Members

OCTOBER 2004

SUGGESTED ROUTING

Continuing Education
Legal and Compliance
Registered Representatives
Registration
Senior Management
Training

KEY TOPICS

Continuing Education
Regulatory Element
Rule 1120

GUIDANCE

Regulatory Element Exemptions

SEC Approves Amendments to Rule 1120 to Eliminate Exemptions from the Continuing Education Regulatory Element Requirements; **Effective Date: Anticipated April 2005; Specific Date to be Announced in Future**
Notice to Members

Executive Summary

On September 27, 2004, the Securities and Exchange Commission (SEC) approved amendments to NASD Rule 1120 (Continuing Education Requirements) to eliminate all current exemptions from the continuing education Regulatory Element requirements. The text of the amendments is set forth in Attachment A. The amendments will become effective on the later of: (1) April 4, 2005; or (2) 30 days following the implementation of the necessary related changes to Web CRD®. NASD will announce the specific effective date, which shall be on or after April 4, 2005, in a future *Notice to Members*.

Questions/Further Information

Questions concerning this *Notice* may be directed to Ann M. Griffith, Associate Vice President and Director, NASD Testing and Continuing Education Department, at (240) 386-5051; Joe McDonald, Associate Director, NASD Testing and Continuing Education Department, at (240) 386-5065; or Patricia Albrecht, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8026.

Background

NASD Rule 1120 specifies the continuing education (CE) requirements for registered persons subsequent to their initial qualification and registration with NASD. The requirements consist of a Regulatory Element component outlined in Rule 1120(a) and a Firm Element component outlined in Rule 1120(b).¹ The Regulatory Element is a computer-based education program administered by NASD to help ensure that registered persons are kept up-to-date on regulatory, compliance, and sales practice matters in the industry.² Unless exempt, each registered person is required to complete the Regulatory Element initially within 120 days after the person's second registration anniversary date and, thereafter, within 120 days after every third registration anniversary date.³ There are three Regulatory Element programs: the S201 Supervisor Program for registered principals and supervisors, the S106 Series 6 Program for Series 6 representatives, and the S101 General Program for Series 7 and all other registrations. Registered persons who fail to complete the Regulatory Element are deemed inactive, must cease all activities as a registered person, and are prohibited from performing any duties and functioning in any capacity requiring registration.⁴

Approximately 135,000 registered persons currently are exempt from the Regulatory Element. These include registered persons who, when the CE Program was adopted in 1995, had been registered for at least ten years and who did not have a significant disciplinary action⁵ in their CRD record for the previous ten years ("grandfathered" persons). Also included are those persons who "graduated" from the Regulatory Element by satisfying their tenth anniversary requirement before July 1998, when Rule 1120 was amended and the graduation provision eliminated, and who did not have a significant disciplinary action in their CRD record for the previous ten years.⁶

At its December 2003 meeting, the Securities Industry/Regulatory Council on Continuing Education (Council)⁷ discussed the current exemptions from the Regulatory Element and agreed unanimously to recommend that the SROs repeal the exemptions and require all registered persons to participate in the Regulatory Element. In reaching this conclusion, the Council was of the view that there is great value in exposing all industry participants to the benefits of the Regulatory Element, in part because of the significant regulatory issues that have emerged over the past few years. The Regulatory Element programs include teaching and training content that is continuously updated to address current regulatory concerns as well as new products and trading strategies. Exempt persons currently do not have the benefit of this material.⁸

Discussion

Based on the Council's recommendation, NASD proposed changes to Rule 1120 in June 2004 to eliminate all currently effective exemptions from the requirement that registered persons complete the Regulatory Element of the CE Program.⁹ The SEC approved those rule changes on September 27, 2004.¹⁰ The amendments become effective on the later of: (1) April 4, 2005; or (2) 30 days following the implementation of the necessary related changes to Web CRD. NASD will announce the specific effective date, which shall be on or after April 4, 2004, in a future *Notice to Members*.

The reentry into the Regulatory Element program of all formerly exempt registered persons will occur over a three-year period using each registered person's "base date." Usually, the base date is the person's initial securities registration. However, the base date may be revised to be the effective date of a significant disciplinary action in accordance with Rule 1120(a)(3) or the date on which a formerly registered person re-qualifies for association with an NASD member by qualification exam. Using the base date, CRD will then create a Regulatory Element requirement on the second anniversary of the base date and then every three years thereafter. Every registered person formerly exempt from the Regulatory Element requirement must satisfy such requirement on the occurrence of a Regulatory Element base date anniversary (*i.e.*, the second anniversary of the base date and every three years thereafter) (see examples in the table below).

NASD staff has reviewed a projection of how the anniversaries of the approximately 135,000 formerly exempt registered persons will occur using the base dates that CRD maintains for these persons. The projection shows that within three years from the proposed rule's effective date, all formerly exempt registered persons will have been brought into the Regulatory Element program. Furthermore, anniversaries will occur at a more-or-less steady rate so that there would be no extraordinary stress placed upon the capacity of the existing test/training facilities during the next three years or thereafter.

Table

Registered Person	Initial Registration Date	First Regulatory Element Requirement of a Registered Person Formerly Exempt from the Regulatory Element (assuming an effective date of April 4, 2005)
A	4/4/1985 ¹¹	4/4/2005
B	7/1/1983	7/1/2006
C	8/1/1984	8/1/2007
D	4/3/1985	4/3/2008

NASD plans on informing each firm of its currently exempted registered persons who will be reentered into the Regulatory Element program. In November 2004, NASD will send an e-mail (and a follow-up hard copy letter) to each firm's Regulatory Element contact person listing each currently exempted registered person and the date on which such person will be required to complete his or her Regulatory Element requirement. NASD will send reminder e-mails to each Regulatory Element contact person in January 2005 and again in March 2005.

The Regulatory Element programs are administered at conveniently located test centers operated by Pearson and Prometric professional testing center networks. Appointments to take the Regulatory Element sessions can be scheduled through either network:

Pearson Professional Centers: contact Pearson VUE's National Registration Center at **1-866-396-6273 (toll free)**, or **1-952-681-3873 (toll number)** or go to www.pearsonvue.com/nasd for Web-based scheduling.

Prometric Testing Centers: contact Prometric's National Call Center at **1-800-578-6273 (toll free)** or go to www.prometric.com/nasd for Web-based scheduling.

For more information about the Council's Continuing Education Program, see the Council's Web site at www.securitiescep.com.

Endnotes

- 1 The Firm Element of the CE Program applies to any person registered with an NASD member firm who has direct contact with customers in the conduct of the member's securities sales, trading, and investment banking activities; any person registered as a research analyst pursuant to Rule 1050; and to the immediate supervisors of such persons (collectively called "covered registered persons"). The requirement stipulates that each member firm must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skill, and professionalism. Each firm has the requirement to annually conduct a training needs analysis, develop a written training plan, and implement the plan.
- 2 Rule 1120(a)(6) permits a member firm to deliver the Regulatory Element to registered persons on firm premises (In-Firm Delivery) as an option to having persons take the training at a designated center provided that firms comply with specific requirements relating to supervision, delivery sites, technology, administration, and proctoring. In addition, Rule 1043 requires that persons serving as Proctors for the purposes of In-Firm Delivery must be registered.
- 3 See Rule 1120(a)(1). This is the current Regulatory Element schedule, as amended in 1998.
- 4 Rule 1120(a)(2).

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- 5 For purposes of Rule 1120, a significant disciplinary action generally means a statutory disqualification, a suspension, or imposition of a fine of \$5,000 or more, or being subject to an order from a securities regulator to re-enter the Regulatory Element. See Rule 1120(a)(3).
- 6 When Rule 1120 was first adopted in 1995, the Regulatory Element schedule required registered persons to satisfy the Regulatory Element on the second, fifth, and tenth anniversaries of their initial securities registration. After satisfying the tenth anniversary requirement, a person was "graduated" from the Regulatory Element. A graduated principal re-entered the Regulatory Element if he or she incurred a significant disciplinary action. A graduated person who was not a principal re-entered if he or she acquired a principal registration or incurred a significant disciplinary action.
- 7 As of the date of this *Notice*, the Council consists of 20 individuals, six representing self-regulatory organizations (SROs) (the American Stock Exchange LLC, the Chicago Board Options Exchange, Inc., the Municipal Securities Rulemaking Board, NASD, the New York Stock Exchange, Inc. (NYSE), and the Philadelphia Stock Exchange, Inc.) and 14 representing the industry. The Council was organized in 1995 to facilitate cooperative industry/regulatory coordination of the CE Program in keeping with applicable industry regulations and changing industry needs. Its roles include recommending and helping to develop specific content and questions for the Regulatory Element, defining minimum core curricula for the Firm Element, developing and updating information about the program for industry-wide dissemination, and maintaining the program on a revenue-neutral basis while assuring adequate financial reserves.
- 8 In addition, the Council plans to introduce a new content module to the Regulatory Element programs in 2005 that will specifically address ethics and will require participants to recognize ethical issues in given situations. Participants will be required to make decisions in the context of, for example, peer pressure, the temptation to rationalize, or a lack of clear-cut guidance from existing rules or regulations. The Council strongly believes that all registered persons, regardless of their years of experience in the industry, should have the benefit of this training.
- 9 See SR-NASD-2004-98. The proposed rule changes also replaced references in Rule 1120(a)(3) to "re-entry" into the Regulatory Element with a requirement to "retake" the Regulatory Element to clarify that the significant disciplinary action provisions apply to all registered persons and not only to currently exempt persons.
- 10 Exchange Act Release No. 50456 (September 27, 2004); 69 F.R. 59285 (October 4, 2004). The SEC also approved amendments to NYSE Rule 345A to eliminate all currently effective exemptions from the requirement that registered persons complete the Regulatory Element of the CE program. See Exchange Act Release No. 50404 (September 16, 2004), 69 F.R. 57126 (September 23, 2004).
- 11 A registered person with an initial registration date of April 4, 1985 will have a Regulatory Element anniversary date on April 4 of 1987, 1990, 1993, 1996, 1999, 2002, and 2005.

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ATTACHMENT A

New language is underlined; deletions are in brackets.

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1120. Continuing Education Requirements

This Rule prescribes requirements regarding the continuing education of certain registered persons subsequent to their initial qualification and registration with NASD. 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 the occurrence of their second registration anniversary date and every three years thereafter, or as otherwise prescribed by NASD [the Association]. On each occasion, the Regulatory Element must be completed within 120 days after the person's registration anniversary date. A person's initial registration date, also known as the "base date," shall establish the cycle of anniversary dates for purposes of this Rule. The content of the Regulatory Element shall be determined by NASD [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 — Persons who have been continuously registered for more than 10 years 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 10 years to any disciplinary action 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 that a 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 be required to satisfy the requirements of the Regulatory Element 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 July 1, 1998, shall participate in the Regulatory Element within 120 days after the occurrence of the second registration anniversary date, or every third year thereafter, whichever anniversary date first applies.]

(2) No change.

(3) Disciplinary Actions [Re-entry into Program]

Unless otherwise determined by NASD [the Association], a registered person will be required to retake [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 retake [re-enter] the Regulatory Element [continuing education program] by any securities governmental agency or self-regulatory organization.

The retaking of the Regulatory Element [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. The date of the disciplinary action shall be treated as such person's new base [initial registration] date with NASD [the Association].

(4) through (7) No change.

No change.

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