

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50328; File No. SR-MSRB-2004-04)

September 7, 2004

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to Amendments to Eliminate Exemptions from the Continuing Education Regulatory Element Requirements

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 5, 2004, the Municipal Securities Rulemaking Board (“MSRB” or “Board”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the MSRB. On August 27, 2004, the MSRB filed Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The MSRB is filing herewith a proposed rule change to amend Rule G-3 to eliminate all exemptions from the requirement to complete the Regulatory Element of the Continuing Education (“CE”) Program. The text of the proposed rule change is set forth below. Proposed new language is in *italics*; proposed deletions are in [brackets].

Rule G- 3. Classification of Principals and Representatives; Numerical Requirements;
Testing; Continuing Education Requirements

(a) – (g) No change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Ronald W. Smith, Senior Legal Associate, MSRB, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated August 26, 2004. Amendment No. 1 replaced the original rule filing in its entirety.

(h) Continuing Education Requirements

This section (h) prescribes requirements regarding the continuing education of certain registered persons subsequent to their initial qualification and registration with a registered securities association with respect to a person associated with a member of such association, or the appropriate regulatory agency as defined in section 3(a)(34) of the Act with respect to a person associated with any other broker, dealer or municipal securities dealer (“the appropriate enforcement authority”). The requirements shall consist of a Regulatory Element and a Firm Element as set forth below.

(i) Regulatory Element

(A) Requirements—No broker, dealer or municipal securities dealer 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 section (i) hereof.

[(1)] Each registered person shall complete the Regulatory Element [beginning with] on the occurrence of their second registration anniversary date and every three years thereafter or as otherwise prescribed by the Board. 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 section (i). The content of the Regulatory Element shall be determined by the Board for each registration category of persons subject to the rule.

[(2)] Persons who have been continuously registered for more than

10 years as of the effective date of this section are exempt from the requirements of this rule relative to participation in the Regulatory Element, provided such persons have not been subject to any disciplinary action within the last 10 years as enumerated in paragraphs (i)(C)(1)-(2) of this section. However, persons delegated supervisory responsibility or authority pursuant to rule G-27 and registered in such supervisory capacity are exempt from participation in the Regulatory Element under this provision only if they have been continuously registered in a supervisory capacity for more than ten years as of the effective date of this rule and provided that such supervisory person has not been subject to any disciplinary action under paragraphs (i)(C)(1)-(2) of this section.]

[(3) In the event that a registered person who is exempt from participation in the Regulatory Element subsequently becomes the subject of a disciplinary action as enumerated in paragraphs (i)(C)(1)-(2), such person shall be required to satisfy the requirements of the Regulatory Element as if the date the disciplinary action becomes final is the person's initial registration anniversary date.]

(B) No change.

(C) [Re-entry into Program] Disciplinary Actions—Unless otherwise determined by the appropriate enforcement authority, a registered person will be required to [re-enter] retake the Regulatory Element and satisfy all of its requirements in the event such person:

(1) becomes subject to any statutory disqualification as defined in

Section 3(a)(39) of the Securities Exchange Act of 1934;

(2) becomes 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, the appropriate enforcement authority or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding;
or

(3) is ordered as a sanction in a disciplinary action to [re-enter] retake the [continuing education program] Regulatory Element by any securities governmental agency, the appropriate enforcement authority or securities self-regulatory organization.

[Re-entry] The retaking of the Regulatory Element shall commence with [initial] participation within 120 days of the registered person becoming subject to the statutory disqualification, in the case of (1) above, or the completion of the sanction or the disciplinary action becomes final, in the case of (2) or (3) above. The date that the disciplinary action becomes final will be deemed the person's [initial registration anniversary] new base date for purposes of this section (i).

(D) - (G) No change.

(ii) No change.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the MSRB included statements concerning the purpose of and basis for the proposed rule change, as amended, and discussed any comments it received

on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. MSRB has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Rule G-3(h), on CE requirements, specifies the CE requirements for registered persons subsequent to their initial qualification and registration. The requirements consist of a Regulatory Element and a Firm Element.⁴ 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.⁵ 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.⁶ There are three Regulatory Element programs: the S201 Supervisor Program for registered principals and supervisors; the S106 Series 6 Program for

⁴ The Firm Element of the CE Program applies to any person registered with an MSRB registered firm who has direct contact with customers in the conduct of the dealer's municipal securities sales, trading and investment banking activities and to the immediate supervisors of such persons (collectively called "covered registered persons"). The requirement stipulates that each firm must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skill and professionalism. Each firm is required annually to conduct a training needs analysis, develop a written training plan, and implement the plan.

⁵ Rule G-3(h)(i)(G) permits a dealer 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 site(s), technology, administration, and proctoring. In addition, Rule G-3(h)(i)(G)(5)(c) requires that persons serving as proctors for the purposes of In-Firm Delivery must be registered.

⁶ This is the current Regulatory Element schedule, as amended in 1998.

Series 6 representatives; and the S101 General Program for Series 7 and all other registrations. 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 action⁷ in their CRD record for the previous ten years (“grandfathered” persons). These also include those persons who had “graduated” from the Regulatory Element by satisfying their tenth anniversary requirement before July 1998, when Rule G-3(h) was amended and the graduation provision eliminated, and who did not have a significant disciplinary action in their CRD records for the previous ten years.⁸

At its December 2003 meeting, the Securities Industry/Regulatory Council on Continuing Education (“Council”)⁹ discussed the current exemptions from the Regulatory Element and

⁷ For purposes of Rule G-3(h), 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 G-3(h)(i)(C).

⁸ When Rule G-3(h) was first adopted in 1995, the Regulatory Element schedule required registered persons to satisfy the Regulatory Element on the second, fifth and tenth anniversary 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.

⁹ As of the date of this rule filing, the Council consists of 17 individuals, six representing self-regulatory organizations (“SROs”) (American Stock Exchange LLC, Chicago Board Options Exchange, Inc., MSRB, NASD, New York Stock Exchange, Inc., and Philadelphia Stock Exchange, Inc.) and 11 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.

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.

In addition, the Council will introduce a new content module to the Regulatory Element programs 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.

Consistent with the Council's recommendation, the proposed rule change eliminates the current Regulatory Element exemptions. The other SRO members of the Council also support eliminating the exemptions and are pursuing amendments to their respective rules.

The effective date of the MSRB proposed rule change is dependent upon the effective date of a similar proposed rule change filed by NASD¹⁰ because NASD administers the Regulatory Element computer-based education program. NASD has stated that it will announce the effective date of its proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. NASD stated that the effective date will be (1)

¹⁰ See Securities Exchange Act Release No. 50204 (August 16, 2004), 69 FR 51873 (August 23, 2004) (SR-NASD-2004-098).

not more than 30 days following publication of the Notice to Members announcing Commission approval, (2) not more than 30 days following the implementation of necessary changes to Web Central Registration Depository (Web CRD), or (3) April 4, 2005, whichever date is the latest to occur. The effective date of the MSRB proposed rule change will be the same as the effective date of the NASD's proposed rule change.

Following the effective date of the proposed rule change, implementation will be based on the application of the existing requirements of the Regulatory Element (Rule G-3(h)(i)(A)) to all registered persons. The way in which CRD applies these requirements is as follows. CRD establishes a "base date" for each registered person and calculates anniversaries from that date. Usually, the base date is the date of 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 G-3(h)(i)(C) 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 creates a Regulatory Element requirement on the second anniversary of the base date and then every three years thereafter. Beginning on or after the effective date of the proposed rule change, registered persons 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).¹¹

NASD staff has reviewed a projection of how the anniversaries of the formerly exempt registered persons (about 135,000 persons) will occur using the base dates that CRD maintains

¹¹ Bank dealers do not have access to CRD. Each bank dealer must track the base date of each of its employees and schedule appointments for those employees to complete the Regulatory Element when required. When developing its plan to bring formerly exempt registered persons into the CRD system, NASD believed that the number of employees of non-NASD member firms who would be affected would not impact the delivery plan significantly.

for these persons. The projection shows that within three years from the proposed amendments' 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.

In addition, the proposed rule amendment would replace references in Rule G-3(h)(i)(C) 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.

2. Statutory Basis

The MSRB believes that the proposed rule change is consistent with Section 15B(b)(2)(C) of the Act, which authorizes the MSRB to adopt rules that shall:

be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.

The MSRB believes that the proposed rule change is consistent with the Act by ensuring that all registered persons are kept up-to-date on industry rules, regulations and practices.

B. Self-Regulatory Organization's Statement on Burden on Competition

The MSRB does not believe that the proposed rule change, as amended, will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

The MSRB has neither solicited nor received comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-MSRB-2004-04 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-MSRB-2004-04. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies

of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing also will be available for inspection and copying at the principal offices of the MSRB. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2004-04 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland
Deputy Secretary

¹² 17 CFR 200.30-3(a)(12).