

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50204; File No. SR-NASD-2004-098)

August 16, 2004

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to Proposed 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 June 25, 2004, the National Association of Securities Dealers, Inc. (“NASD”), filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. On July 23, 2004, NASD 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

NASD proposes to amend NASD Rule 1120 to eliminate all exemptions from the requirement to complete the Regulatory Element of the Continuing Education (“CE”) Program. Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in [brackets].

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Grace Yeh, Assistant General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation (“Division”), Commission, dated July 22, 2004. In Amendment No. 1, the NASD replaced in its entirety the original rule filing.

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.

(b) 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, NASD included statements concerning the purpose of and basis for the proposed rule change 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. NASD 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

NASD Rule 1120 (CE Requirements) specifies the CE requirements for registered persons subsequent to their initial qualification and registration with NASD. 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 Series 6 representatives, and the S101 General Program for Series 7 and all other registrations.

⁴ 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 NASD 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.

⁵ NASD 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 site(s), technology, administration, and proctoring. In addition, NASD Rule 1043 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.

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 NASD 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.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 agreed unanimously to recommend that the SROs repeal the exemptions and require all

⁷ For purposes of NASD 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 NASD Rule 1120(a)(3).

⁸ When NASD 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 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”) (the American Stock Exchange LLC, the Chicago Board Options Exchange, Inc., the Municipal Securities Rulemaking Board, NASD, the New York Stock Exchange, Inc., and the 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.

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 would eliminate 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. NASD staff will coordinate with the staffs of the other SROs to synchronize the rule changes.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be (1) 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.

Following the effective date of the proposed rule change, implementation will be based on the application of the existing requirements of the Regulatory Element (NASD Rule 1120(a)(1)) 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 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 NASD 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 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) (see examples in the Table below).

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 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 ¹⁰	4/4/2005
B	7/1/1983	7/1/2006
C	8/1/1984	8/1/2007
D	4/3/1985	4/3/2008

In addition, the proposed rule change would replace references in NASD 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.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,¹¹ in general and with Section 15A(b)(6) of the Act,¹² in particular, which requires, among other things, that NASD’s rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change is

¹⁰ 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.

¹¹ 15 U.S.C. 78o-3.

¹² 15 U.S.C. 78o-3(b)(6).

designed to accomplish these ends 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

NASD does not believe that the proposed rule change will result in any burden on competition that is 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

Written comments were neither solicited nor received.

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-NASD-

2004-098 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-NASD-2004-098. 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 office of the NASD. 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-NASD-2004-098 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 authority¹³.

Margaret H. McFarland
Deputy Secretary

¹³ 17 CFR 200.30-3(a)(12).