



The Securities Industry Continuing Education Program  
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## Securities Industry Continuing Education Program

### Firm Element Advisory (November 2006)

Each year, the Securities Industry/Regulatory Council on Continuing Education (the “Council”) publishes the Firm Element Advisory (“FEA”) to identify current 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 organizations (“SRO”) publications and announcements of significant events.

The Council suggests that firms use the FEA as an aid in developing their Firm Element Needs Analysis. Firms should review the FEA and determine which topics would be relevant for inclusion in Firm Element training based on the firm’s product offerings, structure and business line(s).

The FEA is designed to identify each topic briefly and then provide links to relevant documents issued on the specified subjects. Although the FEA is now designed for use on the web, the document can be printed. Be advised that separate printing would need to be conducted for each link to encompass the full document and subjects covered.

In addition to the FEA material, the Firm Element Organizer is an additional resource that can assist with developing Firm Element training plans. This is an easy-to-use software application that enables the search of an extensive database of regulatory resources related to specific investment products or services. The results of a search can then be edited into a document that may assist in developing a Firm Element training plan.

For more information, log on to [www.securitiescep.com](http://www.securitiescep.com), or call **Joe McDonald**, Associate Director, Testing & Continuing Education, NASD, at (240) 386-5065, or **Roni Meikle**, Director, Continuing Education, NYSE Regulation, at (212) 656-2156.

# Alternative Investments

## Structured Products

Many industry participants offer complex structured products whose risks may not be readily apparent. Firms may not be fulfilling their sales practice obligations when selling these instruments, especially to retail customers. NASD provides guidance to members concerning their obligations when selling structured products.

*[NASD Notice to Members 05-59](#) - NASD Provides Guidance Concerning the Sale of Structured Products (September 2005).*

## New Products

An increasing number of complex products are being introduced to the market in response to the demand for higher returns or yields. Several communications have been issued that discuss the proactive approach firms should take to review and improve their procedures for developing and vetting these new products.

*[NASD Notice to Members 05-26](#) - NASD Recommends Best Practices for Reviewing New Products (April 2005).*

*[NYSE Information Memo 05-11](#) - Customer Account Sweeps into Bank.*

*NYSE Informed Investor bulletin – The Cash Sweep Account: What Deal Are You Getting?*

*[NYSE Rule 401 \(Business Conduct\); Rule 405 \(Diligence as to Accounts\)](#).*

*[NASD Notice to Members 05-50](#) - Member Responsibilities for Supervising Sales of Unregistered Equity Indexed Annuities (August 2005).*

*[NASD Notice to Members 03-71](#) - NASD Reminds Members of Obligations When Selling Non-Conventional Investments (November 2003).*

## Hedge Funds

Hedge funds pool investors' money and invest those funds in financial instruments in an effort to make a positive return. Many hedge funds seek to profit in all kinds of markets by pursuing leveraging and other speculative investment practices that may increase the risk of investment loss. Neither hedge funds nor, in most cases, the advisers to hedge funds are currently required to register with the SEC. Firms are reminded of their sales practice obligations when selling hedge funds and funds of hedge funds.

*[NASD Notice to Members 03-07](#) - NASD Reminds Members of Obligations When Selling Hedge Funds (February 2003).*

*NYSE Informed Investor bulletin “[Hedge Fund Investing: Is It a Suitable Investment for You](#)”*

## **Non-Managed Fee-Based Account Programs (NMFBA Programs)**

Firms should be cognizant of the obligation to monitor non-managed, fee-based account programs, particularly as it pertains to the suitability of such accounts for customers who conduct minimal transactions.

*[NYSE Information Memo 05-51](#) - Non-Managed Fee-Based Account Programs (Rule 405A).*

*[NASD Notice to Members 03-68](#) - NASD Reminds Members That Fee-Based Compensation Programs Must Be Appropriate (November 2003).*

## **Exchange-Traded Funds**

An Exchange-Traded Fund (“ETF”) is similar to a mutual fund as it typically represents a basket of underlying securities. Unlike a mutual fund, however, an ETF trades like a stock and investors can buy and sell it throughout the trading day. Purchases and sales of ETFs may involve transaction fees different than those for mutual funds, which can impact their costs to investors. As the number of ETFs being offered has significantly increased so has the number of retail investors exposed to ETF investment opportunities.

*[NYSE Informed Investor bulletin “What You Should Know About Exchange Traded Funds.”](#)*

## **Non-Purpose Margin Loans**

On September 7, 2005, the SEC approved amendments to NYSE Rule 352 (Guarantees, Sharing in Accounts, and Loan Arrangements). Rule 352 generally prohibits members, member organizations, and specified persons associated therewith from entering into arrangements that guarantee the payment of a debit balance in any customer account; guarantee a customer against loss; or establish a profit and/or loss-sharing agreement with a customer. The amendments incorporate specific limitations on loan arrangements between registered personnel associated with member organizations and prescribed public customers. As amended, Rule 352 allows loan arrangements between registered persons and public customers under circumstances similar to the permissible loan arrangements under NASD Rule 2370.

*[NYSE Information Memo 05-70](#) - Amendments to Rule 352.*

## **Anti-Money Laundering**

### **Broker-Dealer Customer Identification Program Rule**

On April 29, 2003, the SEC and the U.S. Department of the Treasury jointly adopted the broker-dealer customer identification program (“CIP”) Rule. The CIP Rule requires broker-dealers to implement customer identification programs that include procedures for: (1) verifying the identities of customers; (2) maintaining records of the verification process; (3) comparing customers with lists of known or suspected terrorists or terrorist organizations; and (4) providing customers with notice that information is being collected to verify their identities.

On July 11, 2006, in a [letter to the SIA](#), the SEC Division of Market Regulation extended, for a second time, the no-action relief initially granted in its February 12, 2004 letter to the SIA (“[2004 No-action Letter](#)”) regarding the ability of broker-dealers to rely on investment advisers to perform customer identification procedures consistent with the CIP Rule. The July 11, 2006 letter extends the relief provided in the 2004 No-action Letter until the earlier of (1) the date upon which an AML rule for investment advisers becomes effective, or (2) January 12, 2008. The previous extension was granted on February 10, 2005, in a [letter to the SIA](#).

[NASD Anti-Money Laundering web page](#).

[NASD Notice to Members 03-34](#) – *Anti-Money Laundering Customer Identification Programs for Broker/Dealers (June 2003)*.

[SEC’s Spotlight On: Anti-Money Laundering Rules](#).

[NYSE Information Memo 03-32](#) - *Customer Identification Programs for Broker-Dealers*.

## **Section 312 of the USA PATRIOT Act**

On January 4, 2006, the U.S. Department of the Treasury published in the Federal Register proposed and [final rules](#) (which supersede an interim final rule issued on July 23, 2002) regarding the due diligence requirements in section 312 of the USA PATRIOT Act.

[NASD Issue Center: Anti-Money Laundering](#)

## **Anti-Money Laundering Compliance Program**

SROs have enacted amendments to AML Compliance Program rules. The NYSE rule became effective on January 25, 2006 and the NASD new rule text and interpretive material became effective on March 6, 2006.

[NASD Notice to Members 06-07](#) - SEC Approves Amendments to Anti-Money Laundering Compliance Program Rule and Adoption of Interpretive Material (January 2006).

[NYSE Information Memo 06-04](#) - Amendments to Rule 445 (“Anti-Money Laundering Compliance Program”).

## **Bonds**

### **TRACE**

Firms are reminded of their obligations set forth in NASD Rule 6230. On July 1, 2005, the period to report a transaction in a TRACE-eligible security was reduced to 15 minutes. Firms are further reminded that transactions in TRACE-eligible securities that occur in connection with options, credit default swaps, other swaps or similar instruments must be reported to TRACE. TRACE data is available free of charge to investors at [www.nasdbondinfo.com](http://www.nasdbondinfo.com).

[NASD Notice to Members 05-77](#) - *Transactions in TRACE-Eligible Securities That Occur in Connection with Options, Credit Default Swaps, Other Swaps or Similar Instruments Must Be Reported to TRACE (November 2005)*.

***NASD Notice to Members 05-28** - NASD Reminds Members that the TRACE Reporting Period Will Be Reduced to 15 Minutes on July 1, 2005, and Rescinds Interpretive Guidance Regarding Rejected TRACE Transaction Reports (April 2005).*

***NASD Notice to Members 05-02** - Stage Two of the Expansion of Dissemination of TRACE Transaction Data to Begin on February 7, 2005 Instead of February 1, 2005 (January 2005).*

## **Branch Offices**

### **Branch Office Definition**

NASD and the NYSE have revised their rules to create a uniform branch office definition. In addition, NASD has adopted a new Form BR which enables firms to register or report branch offices electronically with NASD, the NYSE and states that require branch registration or reporting, via a single filing through the CRD system.

***NASD Notice to Members 06-12** - Extension of Effective Date of NASD Uniform Branch Office Definition and Certain Form BR and Form U4 Filing Requirements from May 1, 2006 to July 3, 2006 Joint Interpretive Guidance from NASD and the NYSE Relating to Uniform Branch Office Definition Under NASD Rule 3010(g)(2) and NYSE Rule 342.10 (March 2006).*

***NASD Notice to Members 05-67** - SEC Approves Uniform Branch Office Definition and Related Interpretive Material (October 2005).*

***NASD Notice to Members 05-66** - SEC Approves Uniform Branch Office Registration Form (Form BR) and Conforming and Technical Changes to Forms U4 and U5 (October 2005).*

***NYSE Information Memo 06-54** - Branch Office Processing Fees.*

***NYSE Information Memo 06-13** - Joint Interpretive Guidance from NYSE and NASD Relating to the Uniform Branch Office Definition.*

***NYSE Information Memo 05-75** - Approval of Form BR.*

***NYSE Information Memo 05-74** - Branch Office Definition.*

## **Business Continuity Plans**

NASD and the NYSE have issued guidance pertaining to business continuity and contingency plans relating to a potential pandemic. NASD recognizes that, in the event of a global pandemic or similar disaster, some level of regulatory flexibility may be necessary to allow firms to best serve investors and maintain market stability and has solicited comment from members on what specific, short-term regulatory relief may be appropriate and consistent with NASD's mission, and what specific conditions may warrant such relief.

***NYSE Information Memo 06-30** - Guidance Pertaining to Business Continuity and Contingency Plans Relating to a Potential Pandemic.*

***NYSE Information Memo 05-80** - Business Continuity and Contingency Plans.*

*[NASD Notice to Members 06-31](#) - NASD Requests Comment on Regulatory Relief that Should Be Granted in Response to a Possible Pandemic or Other Major Business Disruption (June 2006).*

*[NASD Notice to Members 04-37](#) - SEC Approves Rules Requiring Members to Create Business Continuity Plans and Provide Emergency Contact Information (May 2004). Business Continuity Planning FAQs; NASD Small Firm Business Continuity Plan Template; Example of BCP Disclosure Statement for Introducing Firms With a Clearing Firm Arrangement*

## **Communications**

### **Electronic Communications**

SROs have taken seriously those failures by members to maintain and preserve all required internal communications, and have recently settled actions against members for, among other things, failure to maintain required electronic communications. Members are required to comply with record keeping requirements regarding external and internal communications relating to their “business as such” to ensure that communications will be available and accessible to regulators during the course of examinations and investigations. Firms must maintain, preserve and produce on a timely basis all such communications upon request of regulators, including SRO staff. In particular, when implementing new technology, firms must address maintenance, retrieval and production issues, especially in light of the increasing volume of data.

*NASD webpage, “[Guide to the Internet for Registered Representatives](#)”*

The NYSE has formed an electronic communications task force, which includes NASD and industry representatives to analyze and address evolving technology and applications for firms in light of current SRO/SEC rule requirements.

### **Approval of Correspondence**

NASD has amended Rule 2211 to require a registered principal to approve correspondence sent to 25 or more existing retail customers within any 30 calendar-day period if the correspondence makes any financial or investment recommendation or otherwise promotes a product or service of the member. The effective date of the rule change is December 1, 2006.

*[NASD Notice to Members 06-45](#) - SEC Approves Amendments to NASD Rule 2211 to Require Principal Pre-Use Approval of Certain Member Correspondence Sent to 25 or More Existing Retail Customers within a 30 Calendar-Day Period (August 2006).*

*[NYSE-SR-2005-17](#) - Exemptions from pre-use review and requirements for institutional sales material.*

## Customer Account Transfers

In response to numerous customer complaints and industry frustration about delays in the transfer of securities accounts from one brokerage firm to another, NASD established the Customer Account Transfer Task Force (Task Force) to consider ways to improve the process of inter-firm customer account transfers. The report presents the results of the Task Force's deliberations.

*[Report of the Customer Account Transfer Task Force \(September 2006\).](#)*

*[NYSE Investor Education bulletin "Moving Financial Assets - What Every Customer Should Know."](#)*

*[NYSE Investor Education bulletin "If Your Broker Changes Firms, What Do You Do?"](#)*

*[NYSE Rule 412 \(Customer Account Transfer Contracts\).](#)*

## Financial and Operations Principals

NASD issued a reminder of member firms and registered financial and operations principals (FINOPs) of a FINOP's duties and responsibilities under Rule 1022 (Categories of Principal Registration). These duties are applicable to all FINOPs, regardless of whether they are employed full-time or part-time, perform such duties on-site or off-site of the member firm or hold registrations with more than one firm.

*[NASD Notice to Members 06-23 - NASD Reminds FINOPs of their Obligations under NASD Rule 1022 and Issues Guidance to FINOPS who Work Part-Time, Work Off-Site or Hold Multiple Registrations \(May 2006\).](#)*

*[NYSE Information Memo 06-22 – Executive Responsibilities.](#)*

## Fingerprinting

Members should review and, as necessary, update their fingerprinting procedures to help ensure that fingerprints submitted to the Federal Bureau of Investigation ("FBI") as part of the hiring process belong to the employee being hired by the member. NASD suggests a number of best practices to members that elect to fingerprint prospective employees in-house and those that rely on third parties in an off-site location to collect fingerprints and to verify the identity of the person being fingerprinted.

*[NASD Notice to Members 05-39 - NASD Suggests Best Practices for Fingerprinting Procedures \(May 2005\).](#)*

*[NYSE Rule 345.11 \(Investigation Records\).](#)*

*[NYSE Information Memo 06-39 – Floor Access Finger Print Requirements.](#)*

*[NYSE Information Memo 04-53 - Termination of Fingerprinting Processing Services.](#)*

*[NYSE Information Memo 03-11 - Fingerprint Processing and FBI Identification Records.](#)*

## **Gifts and Business Entertainment**

### **Influencing or Rewarding Employees of Others**

NASD is proposing interpretive material (IM) to Rule 3060 (Influencing or Rewarding Employees of Others) and the NYSE is proposing new Rule 350A (Business Entertainment) to more explicitly outline the policies and procedures a member must adopt in connection with its business entertainment practices with employees of a customer. The proposed rules would expand on and supersede prior staff guidance in this area.

*[NASD Notice to Members 06-06](#) - NASD Requests Comment on Proposed Interpretive Material IM-3060 Addressing Gifts and Business Entertainment (January 2006).*

*[SR-NASD-2006-044](#) – Proposed New IM-3060 to Address Members’ Policies and Procedures on Business Entertainment.*

*[NYSE Rule 350](#) (Compensation or Gratuities to Employees of Others).*

*[SR-NYSE-2006-06](#) – Proposal for New Rule 350A to Regulate “Business Entertainment” Provided by Member Organizations to Representatives of Customers and Potential Customers.*

*[SR-NYSE-2004-60](#) - Proposed Amendment to Rule 350 (Compensation or Gratuities to Employees of Others).*

### **Charitable Contributions**

The solicitation of substantial charitable contributions by employees or agents of a customer acting in a fiduciary capacity raises potential conflicts of interest that deserve careful consideration by member firms. NASD and NYSE have jointly issued guidance to suggest some of the policies and procedures that firms should consider adopting to address these conflicts.

*[NASD Notice to Members 06-21](#) - NASD and NYSE Issue Joint Guidance on Charitable Contributions (May 2006).*

*[NYSE Information Memo 06-27](#) - Charitable Contribution Solicitations from Fiduciaries.*

## **Certain Broker-Dealers Not Deemed to be Investment Advisers**

The SEC adopted Rule 202(a)(11)-1 under the Investment Advisers Act of 1940 (“Advisers Act”) addressing the application of the Advisers Act to broker-dealers offering certain types of brokerage programs. Under the Rule, a broker-dealer providing advice that is solely incidental to its brokerage services is excepted from the Advisers Act if it charges an asset-based or fixed fee, rather than a commission, mark-up, or mark-down, for its services, provided it makes certain disclosures about the nature of its services. The Rule also states that a broker-dealer provides investment advice that is not “solely incidental” to its brokerage services if the broker-dealer charges a separate fee or separately contracts for its advisory services, exercises investment discretion over client

accounts, or holds itself out to the public as a financial planner. The Rule became effective April 15, 2005.

See [SEC Release No. 34-51523](#); *Certain Brokers Deemed not to be Investment Advisers (April 12, 2005)*.

## **Insurance/Annuities**

### **Life Settlements**

Sales of existing life insurance policies to third parties—often referred to as "life settlements"—have grown exponentially in recent years, and that trend appears likely to continue. NASD is reminding member firms and associated persons that life settlements involving variable insurance policies are securities transactions, and firms and associated persons involved in such transactions are subject to applicable NASD rules.

[NASD Notice to Members 06-38](#) - *Member Obligations with Respect to the Sale of Existing Variable Life Insurance Policies to Third Parties (August 2006)*.

### **Market Indexed/Linked Certificates of Deposit**

Recent sales practice reviews have raised regulatory concerns relating to the marketing of certificates of deposit ("CDs") that are linked to market indices. Of particular concern is the adequacy of disclosure materials used in connection with the sale of these instruments to customers and whether registered representatives and customers fully understand the product and how it differs from conventional CDs.

[NYSE Information Memo 06-12](#) - *Disclosures and Sales Practices Concerning Market Indexed/Linked Certificates of Deposit*.

### **Mutual Fund/Variable Annuity Sales Practice and Supervision**

Disclosures made in connection with retail sales of investment company shares (mutual funds) and variable annuities have raised ongoing regulatory concerns, particularly with respect to the recently prohibited practice of directed brokerage, as well as issues involving revenue sharing and suitability. The NYSE has released an information memo clarifying requirements for disclosures and sales practices and to remind member organizations and associated persons of their disclosure obligations under existing NYSE and/or SEC rules.

[NYSE Information Memo 06-38](#) - *Directed Brokerage Arrangements*.

[NYSE Information Memo 05-54](#) - *Disclosures and Sales Practices Concerning Mutual Funds and Variable Annuities*.

### **Sales of Unregistered Equity-Indexed Annuities**

NASD addressed the responsibility of firms to supervise the sale by their associated persons of equity-indexed annuities ("EIAs") that are not registered under the federal securities laws.

[NASD Notice to Member 05-50](#) - *Member Responsibilities for Supervising Sales of Unregistered Equity-Indexed Annuities (August 2005)*.

## Markups/Markdowns

NASD is proposing to expand the scope of Rule 2440 and Interpretive Material (IM) 2440 relating to fair prices and commissions to apply to all securities transactions, whether executed over-the-counter ("OTC") or on an exchange. Currently, Rule 2440 and IM-2440 apply only to transactions executed OTC. The proposal would expand requirements to exchange transactions, such that the standards set forth in Rule 2440 and IM-2440 would apply uniformly to all securities transactions by members, irrespective of whether the transaction is ultimately executed OTC or on an exchange.

*[SEC Release No. 34-53562](#) - Notice of Filing to Expand the Scope of NASD 2440 and Interpretive Material 2440 Relating to Fair Prices and Commissions to All Securities Transactions (April 4, 2006).*

## Municipal Securities

### Municipal Fund Securities

Dealers are reminded that all advertisements of municipal fund securities (including 529 college savings plans) containing performance data submitted or caused to be submitted for publication by a dealer on or after December 1, 2005 must comply fully with MSRB Rule G-21, on advertising. The disclosure requirements are consistent with those required for mutual fund performance under SEC Rule 482.

*[MSRB Notice 2005-58](#); Reminder: New Requirements Relating to Performance Data in Advertisements of 529 College Savings Plans and Other Municipal Fund Securities Become Effective on December 1, 2005 (November 30, 2005).*

On August 7, 2006, interpretive guidance regarding the marketing of 529 college savings plans became effective. The guidance is intended to ensure that dealers effecting transactions in the 529 college savings plan market fully understand their fair practice and disclosure obligations to their customers.

*[MSRB Notice 2006-23](#); Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans Becomes Effective (August 7, 2006), and [MSRB Notice 2006-16](#); SEC Approves Interpretive Notice on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans (June 15, 2006).*

### Transaction Reporting

With few exceptions, MSRB rules require dealers to submit trade records of municipal securities transactions for comparison and transaction reporting within 15 minutes of the time of trade execution. Dealers are allowed three hours to report a trade to the Real-Time Transactions Reporting System (RTRS) if the dealer: (1) does not have a CUSIP

number and indicative data of the issue traded in the securities master file used by the dealer to process trades for confirmation, clearance, and settlement; (2) has not traded the security in the previous year; and (3) did not act as a syndicate manager or syndicate member for the security (three-hour exception). For “when-issued” transactions, this three-hour exception will expire on December 31, 2007, and for all other secondary market transactions, the three-hour exception will expire on December 29, 2006.

The MSRB has a special section on its website, [www.msrb.org](http://www.msrb.org), which offers detailed information on transaction reporting.

***MSRB Notice 2006-17**; Data Quality Detail Report is Available to Dealers (June 16, 2006).*

***MSRB Notice 2006-12**; Industry Preparations for Expiration of Three-Hour Exception from Real-Time Transaction Reporting (April 24, 2006).*

***MSRB Notice 2005-62**; SEC Approves Proposed Rule Change to MSRB Rule G-14 RTRS Procedures, Paragraph (a)(ii)(C) to Extend the Three-Hour Exception (December 22, 2005).*

### **Political Contributions and Solicitation of Municipal Securities Business**

Effective August 29, 2005, the MSRB adopted new Rule G-38, which provides that no broker, dealer or municipal securities dealer (broker-dealer) may pay or provide payment, for, directly or indirectly, any person who is not an affiliated person of such broker-dealer for a solicitation of municipal securities business on behalf of the broker-dealer. On the same day, the MSRB rescinded former Rule G-38, which permitted the use of consultants (persons who were not affiliated persons of a broker-dealer and who solicited municipal securities business on behalf of the broker-dealer). Under new Rule G-38, the MSRB permitted certain “transitional payments” to consultants after the August 29, 2005, the effective date of new Rule G-38, if the payment(s) were made solely with respect to solicitation activities undertaken by the consultant prior to August 29, 2005 pursuant to a consulting agreement in effect under former Rule G-38. On June 8, 2006, the SEC approved an interpretive notice of the MSRB relating to the definition of solicitation for purposes of Rules G-37 and G-38 (the “Solicitation Guidance”). The Solicitation Guidance makes clear that the key element in determining whether a communication is considered a solicitation is whether the communication occurs with the purpose of obtaining or retaining municipal securities business.

***MSRB Notice 2006-15**; SEC Approves Interpretive Notice on the Definition of Solicitation under Rules G-37 and G-38 and Withdrawal of Q & A Guidance (June 15, 2006).*

### **Gifts and Gratuities**

On October 3, 2005, the SEC approved amendments to MSRB Rule G-20, on gifts, gratuities, and non-cash compensation, and the related recordkeeping provisions of Rule G-8. The amendments also became effective on October 3, 2005. The amendments more fully conform MSRB Rule G-20 to current NASD requirements relating to gifts and gratuities, and add new provisions governing non-cash compensation and sales incentives in connection with primary offerings of municipal securities, based on NASD

requirements for non-cash compensation and sales incentives. The MSRB intends that the provisions of Rule G-20 be read consistently with the analogous NASD provisions, unless the MSRB specifically directs otherwise.

*[MSRB Notice 2005-52](#); SEC Approves Amendments to Rule G-20, on Gifts and Gratuities, and Rule G-8, on Books and Records (October 5, 2005).*

## **Mutual Fund Performance Advertising**

The SEC approved amendments to NASD Rules 2210 and 2211 that impose certain disclosure and presentation requirements on member communications with the public, other than institutional sales material and public appearances, that present non-money market mutual fund performance data (performance sales material). Among other things, the amendments require members to disclose a fund's total annual operating expense ratio, gross of any fee waivers. Fund performance advertisements that appear in print publications must include the fund's standardized performance and expense ratio in a prominent text box. The effective date of the amendments is April 1, 2007.

*[NASD Notice to Members 06-48](#) - SEC Approves Amendments to NASD Rules 2210 and 2211 to Require Disclosure of Fees and Expenses in Mutual Fund Performance Sales Material (September 2006).*

## **Research Analyst**

### **Fixed Income Research**

In December 2005, the NYSE and NASD (the "SROs") issued a joint report that assessed the effectiveness of the SRO research analyst conflict of interest rules. Those rules apply only to equity research reports. However, the joint report noted that the SROs would monitor the extent to which firms have adopted the Bond Market Association's "Guiding Principles to Promote the Integrity of Fixed Income Research" ("Guiding Principles"), which are voluntary, principle-based guidelines designed to help firms manage potential conflicts of interest that may arise in the context of fixed income research.

The SROs conducted examinations of certain member firms to assess how those firms have addressed conflicts of interest with respect to fixed income research. The examinations found many instances in which firms had failed to adhere to the Guiding Principles. Even more significantly, the examinations discovered several instances where firms failed to establish, maintain and enforce written supervisory procedures in the fixed income research area – a fundamental obligation under SRO rules – or comply with existing SEC Regulation Analyst Certification.

***NASD Notice to Members 06-36** - NASD and NYSE Joint Interpretive Guidance on Fixed Income Research (July 2006).*

***NYSE Information Memo 06-55** - Joint Guidance on Fixed Income Research From NYSE and NASD.*

***SR-NYSE-2006-77** – Approved 10/17/06 Release No. 34-54616 Proposed Amendments Codify Prior Interpretative Guidance to Research Analyst Conflict Rules.*

***SR-NYSE-2006-78** – Proposed Amendments to Rules 344 and 472 Incorporating SRO Report Recommendations to Research Analyst Conflict Rules.*

***SR-NASD-2006-113** – Proposed Rule Change to Amend NASD Rules 1050 and 2711 Relating to Research Analyst Conflicts of Interest.*

***SR-NASD-2006-112** – Proposed Rule Change to Amend NASD Rule 2711 to Codify Existing Interpretive Guidance Relating to Research Analyst Rules.*

## **Sales Practices**

### **Penny Stocks/Low Priced Securities**

The SEC amended the definition of “penny stock” as well as the requirements for providing certain information to penny stock customers. The amendments are designed to address market changes, evolving communications technology and legislative developments. The amendments became effective on September 12, 2005.

***SEC Release No. 34-51983** - Amendments to the Penny Stock Rules (July 7, 2005).*

### **Directed Brokerage Practices**

NASD amended Rule 2830(k), which governs NASD members’ execution of investment company portfolio transactions. The amended rule augments existing proscriptions on directed brokerage practices by prohibiting a member from selling the shares of, or acting as an underwriter for, any investment company if the member knows or has reason to know that the investment company or its investment adviser or underwriter have directed brokerage arrangements in place that are intended to promote the sale of investment company securities. . The rule change also eliminated a prior provision that permitted funds to consider sales of fund shares in selecting broker-dealers to execute portfolio transactions, subject to prospectus disclosure, best execution requirements, and meeting the other requirements of Rule 2830(k). The rule change became effective February 14, 2005.

***NASD Notice to Members 05-04** - SEC Approves Amendments to NASD Rule 2830(k) to Strengthen Prohibitions on Investment Company Directed Brokerage Arrangements (January 2005).*

## Short Sales – Reg SHO

In July 2004, the SEC adopted new Regulation SHO under the Exchange Act to provide a new regulatory framework governing short selling of securities. Among other things, Regulation SHO: (1) requires broker-dealers to mark sales in all equity securities “long,” “short,” or “short exempt”; (2) includes a temporary rule that establishes procedures for the SEC to suspend temporarily the operation of the current “tick” test and any short sale price test of any exchange or national securities association, for specified securities; (3) requires short sellers in all equity securities to locate securities to borrow prior to selling short; and (4) imposes additional delivery requirements on broker-dealers for securities in which a substantial number of failures to deliver have occurred. Together with the Regulation SHO adopting release, the SEC issued an order (Pilot Order) establishing a one-year pilot suspending the provisions of Rule 10a-1(a) under the Exchange Act and any short sale price test of any exchange or national securities association for short sales of certain securities for specified periods of time. The one-year pilot was extended to August 6, 2007.

*[Short Sales section](#) of the SEC’s website, in particular the [Q&A](#) developed by the Division of Market Regulation.*

*[NYSE Information Memo 06-23](#) - The Securities and Exchange Commission Issues Guidance on Regulation SHO.*

## Supervision

NASD has made technical changes to the requirements for the reporting of customer complaints received by members. Firms are reminded of their obligations to timely submit required reporting information.

*[NASD Notice to Members 06-34](#) - NASD Rule 3070 System Requirements (July 2006).*

*[NYSE Information Memo 06-28](#) - NYSE Rule 351(d) – Reports of Customer Complaint Statistics.*

*[NYSE Rule 351\(a\)\(1\)](#) Guidance on Reporting Requirements*

## Trade/Tape Shredding

NASD and the NYSE recently adopted new rules that prohibit conduct known as “trade shredding” or “tape shredding.” The rules prohibit members and associated persons from splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind payment to the member or associated persons as a result of the execution of such orders or the transaction reporting of such executions.

*[NYSE Information Memo 05-87](#) - Approval of New Rule 123G (Order Entry Practices).*

*[NYSE Information Memo 05-15](#) - Prohibition on “Trade Shredding” and Related Conduct by Members and Member Organizations.*

*[NASD Notice to Members 06-19](#) - SEC Approves New Rule 3380, Order Entry and Execution Practices (April 2006).*

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## To Obtain More Information

For more information about publications contact the SROs at these website addresses:

<b>Self-Regulatory Organization</b>	<b>Online Address</b>
American Stock Exchange	<a href="http://www.amex.com">www.amex.com</a> <a href="http://www.amex.com/amextrader">www.amex.com/amextrader</a>
Chicago Board Options Exchange	<a href="http://www.cboe.com">www.cboe.com</a>
Municipal Securities Rulemaking Board	<a href="http://www.msrb.org">www.msrb.org</a>
NASD	<a href="http://www.nasd.com">www.nasd.com</a>
NYSE Regulation	<a href="http://www.nyse.com">www.nyse.com</a>
Philadelphia Stock Exchange	<a href="http://www.phlx.com">www.phlx.com</a>