



## Securities Industry Continuing Education Program

### Firm Element Advisory - Spring 2010

#### Introduction

The Securities Industry/Regulatory Council on Continuing Education (Council) publishes the Firm Element Advisory (FEA) to highlight current regulatory and sales practice issues for possible inclusion in Firm Element training plans. The Council has identified the topics from a review of industry regulatory and self-regulatory organization (SRO) publications and announcements of significant events.

The Council issues the FEA semi-annually and suggests that firms use it as an aid in developing and updating their Firm Element needs analysis and written training plan. However, firms are reminded that the FEA should not be relied on as a comprehensive list of all areas they consider. Firms should review the FEA and determine which topics are relevant for inclusion in their training based on the firm's product offerings, structure and business line(s).

All new material in the FEA is denoted by a “*(New)*” next to the appropriate title. Material from previous editions that the Council has updated is denoted with an “*(Updated)*.” The Council removes any material from previously published editions of the FEA that is no longer current.

The FEA briefly describes each topic and provides links to relevant documents about the specified subjects. The FEA is designed for Internet use; however, it can be printed. Be advised that you must print the material from each link separately in order to encompass the full document and subjects covered.

Firms have asked the Council for more resources to help them with their Firm Element planning. In response, the Council suggests the following tools that firms may use in addition to the FEA:

- [\*\*The Firm Element Guidance Document\*\*](#): Suggestions for effectively performing the needs analysis and developing written training plans.



- **The Firm Element Content Builder** (Formerly the Firm Element Organizer): A Web-based tool that allows the user to search, by keyword, through an extensive database of regulatory resources related to specific investment products or services.
- **FINRA's 2010 Examination Priorities Letter**: Each year, FINRA issues a letter that highlights new and existing areas of significance to FINRA's examination program. These letters may be useful when developing education programs within a firm.
- **FINRA Investor Alerts**: Periodic alerts that highlight products and sales practices of particular concern that firms may use to supplement training materials.

The Council recommends using all available tools to make Firm Element planning as efficient and effective as possible.

### Questions?

For more information, contact:

- [cecounciladmin@finra.org](mailto:cecounciladmin@finra.org); or
- Roni Meikle, Director, Continuing Education, FINRA, at (646) 315-8688.



## **ALTERNATIVE INVESTMENTS**

### **(New) Reverse Exchangeable Securities (Reverse Convertibles)**

Firms that sell reverse convertibles must ensure that their promotional materials and communications to the public regarding these products are fair and balanced, and do not understate the risks associated with these products. Firms also must ensure that their registered representatives understand the risks, terms and costs associated with these products, and that they perform an adequate suitability analysis before recommending them to any customer.

- [FINRA Regulatory Notice 10-09](#): FINRA Reminds Firms of Their Sales Practice Obligations With Reverse Exchangeable Securities (Reverse Convertibles) (February 2010)

### **(New) Principal Protected Notes**

Firms that sell principal protected notes must ensure that their promotional materials and communications to the public regarding these products are fair and balanced, and do not overstate either the level of protection offered or an investment's potential returns. Firms also have a duty to ensure that their registered representatives understand the risks, terms and costs associated with these products, and that they perform an adequate suitability analysis before recommending them to any customer.

- [FINRA Regulatory Notice 09-73](#): FINRA Reminds Firms of Their Sales Practice Obligations Relating to Principal-Protected Notes (December 2009)

### **Non-Traditional Exchange-Traded Funds (ETFs)**

Leveraged and inverse ETFs are often complex and have unique trading characteristics. For instance, due to the effects of compounding, an ETF's longer-term performance may deviate from its stated daily objective. Firms must have a full understanding of the terms and features of leveraged and inverse ETFs to ensure that:

- all recommendations to customers are suitable;
- sales materials are fair and accurate; and



- adequate supervisory procedures are in place to ensure these obligations are met.
- [FINRA Regulatory Notice 09-31](#): FINRA Reminds Firms of Sales Practice Obligations Relating to Leveraged and Inverse Exchange-Traded Funds (June 2009)

### **Public Offerings of DPPs and REITs**

Firms that provide valuations of Real Estate Investment Trusts (REITs) and Direct Participation Programs (DPPs) on customer account statements must not use par value in a customer account statement more than 18 months following the conclusion of an offering, unless an appraisal of the program's assets and operations yields the same value. Firms also must determine that all material facts are adequately and accurately disclosed, including the amount or composition of the dividend distributions.

- [FINRA Regulatory Notice 09-09](#): Customer Account Statements and Due Diligence Requirements for Unlisted Real Estate Investment Trusts (REITs) and Direct Participation Programs (DPPs) (February 2009)

### **ANTI-MONEY LAUNDERING (AML)**

In September 2009, the SEC approved the adoption of NASD Rule 3011 (Anti-Money Laundering Compliance Program) without substantive change into the Consolidated FINRA Rulebook as FINRA Rule 3310 (Anti-Money Laundering Compliance Program). The SEC also approved the adoption of NASD IM-3011-1 (Independent Testing Requirements), subject to certain amendments, and NASD IM-3011-2 (Review of AML Compliance Person Information), without substantive change as supplementary material to FINRA Rule 3310. FINRA Rule 3310 does not retain the exception in NASD IM-3011-1 that permitted, under certain conditions, the AML compliance program testing to be conducted by persons who report to either the AML compliance person or persons performing the functions being tested.

The Financial Crimes Enforcement Network (FinCEN), a bureau within the Department of the Treasury that is responsible for administering the Bank Secrecy Act (BSA) and its implementing regulations, has stated that the independent testing provision of the BSA precludes AML program testing by personnel with an interest in the outcome of the testing, and that an independent testing



exception, such as the one in NASD IM-3011-1, is inconsistent with the BSA's independent testing provision and FinCEN's interpretation of this provision. FINRA Rule 3310 took effect on January 1, 2010.

- [FINRA Regulatory Notice 09-60](#): SEC Approval and Effective Dates for New Consolidated FINRA Rules (October 2009)

## AML Compliance

Information and guidance relating to AML rules, regulations and compliance is issued regularly from a number of sources, such as the following. Firms are reminded to maintain current AML programs and train staff appropriately.

- [FINRA Issue Center: Anti-Money Laundering](#)
- [AML Template for Small Firms](#)

The SEC has updated the AML Source Tool to include guidance on the scope of permissible information sharing covered by Section 314(b), a Safe Harbor of the USA PATRIOT Act (June 2009).

- [SEC AML Source Tool](#)

## SEC Suspicious Activity Report Alert Message Line

The SEC maintains a Suspicious Activity Report (SAR) Alert Message Line that securities firms can use to voluntarily report the filing of a SAR that may require the SEC's immediate attention. Placing a call to the SEC SAR Alert Message Line does not alleviate a firm's obligation to file a SAR or notify an appropriate law enforcement authority.

- [SEC AML Source Tool](#)

## **(New)** ARBITRATION RULES

The following amendments to the Customer and Industry Codes of Arbitration apply to claims filed on or after January 18, 2010:

- clarify the definition of "associated person" and make it conform to the same term in the FINRA By-Laws;



- streamline a case administration procedure; and
  - clarify that customers could be assessed hearing session fees based on their own claims for relief in connection with an industry claim.
- [\*\*FINRA Regulatory Notice 09-74\*\*](#): SEC Approves Changes to Arbitration Rules on Definition of Associated Person, Distribution of the FINRA Discovery Guide and Applicability of Hearing Session Fees (December 2009)

Amendments to Rules 12601 and 12902 of the Customer Code and Rules 13601 and 13902 of the Industry Code clarify the applicability of the fee waiver provision of the postponement rule and codify the hearing session fee for an unspecified damages claim heard by one arbitrator. Additionally, amendments to Rule 12213 of the Customer Code and Rule 13213 of the Industry Code expand the criteria for selecting a hearing location for an arbitration proceeding.

- [\*\*SR-FINRA-2009-075\*\*](#): Regulatory Notice to be published; Effective Date is on or after May 3, 2010
- [\*\*SR-FINRA-2009-073\*\*](#): Regulatory Notice to be published; Effective Date is on or after May 3, 2010

Effective March 22, 2010, the Codes of Arbitration Procedure for Customer and Industry disputes are amended to clarify that if a claim deficiency is corrected within 30 days from the time a party receives notice of a deficiency, the claim will be considered filed on the date the initial statement of claim was filed.

- [\*\*FINRA Regulatory Notice 10-11\*\*](#): Amendments to the Arbitration Rules Regarding Deficient Claims (March 2010)

## **BUSINESS CONTINUITY**

In August 2009, the SEC approved the adoption of NASD Rules 3510 (Business Continuity Plans) and 3520 (Emergency Contact Information) without significant change into the Consolidated FINRA Rulebook as FINRA Rule 4370 (Business Continuity Plans and Emergency Contact Information). FINRA Rule 4370, however, modifies the requirement in NASD Rule 3520 that a member firm designate two emergency contact persons who are both registered principals and members of senior management to require that only one of those associated persons be a member of senior management and a registered principal of the firm.



FINRA Rule 4370 also requires that someone designated as a second emergency contact person who is not a registered principal be a member of senior management who has knowledge of the firm's business operations. Additionally, if a firm has only one associated person (*e.g.*, a sole proprietorship without any other associated persons), FINRA Rule 4370 permits the second emergency contact person to be an individual, either registered with another firm or nonregistered, who has knowledge of the firm's business operations, such as the firm's attorney, accountant or clearing firm contact. FINRA Rule 4370 took effect on December 14, 2009.

- [FINRA Regulatory Notice 09-60](#): SEC Approval and Effective Dates for New Consolidated FINRA Rules (October 2009)

## **Business Continuity Planning**

Business continuity remains a priority for firms and their associated persons. It is important that firms maintain adequate business continuity and contingency plans and ensure that employees are aware of and understand these plans.

- [FINRA Industry Issues Center - Business Continuity Planning](#)

## **COMMUNICATION WITH THE PUBLIC**

### **(New) Blogs and Social Networks**

Americans are increasingly using social media Web sites, such as blogs and social networking sites, for business and personal communications. FINRA [Regulatory Notice 10-06](#) provides guidance to firms on how FINRA's communications with the public rules apply to social media sites sponsored by a firm or a registered representative. The guidance covers recordkeeping, suitability, supervision and other compliance concerns. See the related [news release](#). A podcast with guidance on social networking issues is also available on FINRA's Web site.

- [FINRA Regulatory Notice 10-06](#): Guidance on Blogs and Social Networking Web Sites (January 2010)
- **FINRA Compliance Podcast: Social Networking**  
[Listen Now/Download](#) | 10 min. 52 sec.



In addition, the FINRA Website now offers two on-demand webinars on social networking:

- [Compliance Considerations for Social Networking Sites](#)
- [Implementing Compliance Practices for Social Networking Sites](#)

## Electronic Communications

Firms are reminded to maintain and preserve all required communications, comply with recordkeeping requirements regarding external and internal communications and address supervision, maintenance, retrieval and production issues, especially in light of the ever-increasing volume of data and methods of communication.

- [FINRA Regulatory Notice 07-59](#): FINRA Provides Guidance Regarding the Review and Supervision of Electronic Communications (December 2007)
- [FINRA Issue Center: Advertising](#): Guide to the Internet for Registered Representatives
- [FINRA Compliance Podcast: Electronic Communications: Social Networking Web Sites](#) (March 10, 2009) [Listen Now/Download](#) |6 min. 11 sec.

## Market Letters

Firms are now permitted to supervise “market letters” as correspondence rather than sales literature, unless the letters are distributed to 25 or more existing retail customers within a 30-calendar-day period and make a financial or investment recommendation, or otherwise promote the firm’s product or service.

- [FINRA Regulatory Notice 09-10](#): SEC Approves Rule Relating to Supervision of Market Letters (February 2009)

## SIPC Information

Subject to certain exceptions, FINRA Rule 2266 (SIPC Information) requires firms to advise all new customers, in writing, at the opening of an account, that



they may obtain information about SIPC, including the SIPC brochure, by contacting SIPC. Such firms also must provide SIPC's Web site address and telephone number. In addition, firms must provide all customers with the same information, in writing, at least once each year.

- [FINRA Regulatory Notice 09-33](#): SEC Approval and Effective Dates for New Consolidated FINRA Rules (June 2009)

### **(New) CONSOLIDATED FINRA RULEBOOK**

Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA established a process to develop a new consolidated rulebook (the Consolidated FINRA Rulebook). FINRA is proposing new consolidated rules in phases for approval by the SEC as part of the Consolidated FINRA Rulebook. FINRA announces the effective dates for all new consolidated FINRA rules in *Regulatory Notices*. See the following *Notices* for the effective dates of new consolidated FINRA rules that the SEC has approved since the Fall 2009 Firm Element Advisory.

- [FINRA Regulatory Notice 10-10](#): SEC Approval and Effective Date for New Consolidated FINRA Rules; Effective Date: April 19, 2010
- [FINRA Regulatory Notice 10-04](#): SEC Approves Consolidated FINRA Rules Governing Clearly Erroneous Transactions; Effective Date: February 15, 2010
- [FINRA Regulatory Notice 09-72](#): SEC Approval and Effective Dates for New Consolidated FINRA Rules; Effective Date (all rules except FINRA Rule 2330): February 15, 2010; FINRA Rule 2330: February 8, 2010
- [FINRA Regulatory Notice 09-71](#): SEC Approves Consolidated FINRA Rules Governing Financial Responsibility; Effective Date: February 8, 2010

### **Rule Conversion Charts**

To facilitate the transition to the Consolidated FINRA Rulebook, FINRA created three rule conversion charts that map NASD and Incorporated NYSE rules to new FINRA rules and vice versa. FINRA updates these charts as the effective dates of FINRA rules are announced.

**Important Note:** These conversion charts are intended as reference aids only and do not serve as substitutes for diligent review of the relevant rule language.



- [FINRA Rule Conversion Charts](#)

## **CORPORATE FINANCE AND INSTITUTIONAL BUSINESS**

### **Conflicts of Interest**

Firms must comply with the new requirements of NASD Rule 2720 (Public Offerings of Securities with Conflicts of Interest), which governs public offerings of securities in which a member firm with a conflict of interest participates. The new rule amends and replaces the previous version of NASD Rule 2720 in its entirety.

- [FINRA Regulatory Notice 09-49](#): SEC Approves Amendments to Modernize and Simplify NASD Rule 2720 Relating to Public Offerings in Which a Member Firm With a Conflict of Interest Participates (August 2009)

### **Member Private Offerings**

Firms and associated persons that engage in a private placement of the firm's securities or those of a control entity must comply with certain disclosures and filing requirements and limitations of the use of proceeds as set forth in FINRA Rule 5122.

- [FINRA Regulatory Notice 09-27](#): SEC Approves New FINRA Rule 5122 Relating to Private Placements of Securities Issued by a Member Firm or a Control Entity (May 2009)

### **Resales of Unregistered Restricted Securities**

Firms that participate in unregistered resales of restricted securities are reminded of their responsibilities to comply with certain federal securities laws and FINRA rules.

- [FINRA Regulatory Notice 09-05](#): FINRA Reminds Firms of Their Obligations to Determine Whether Securities are Eligible for Public Sale (January 2009)



## **CUSTOMER ACCOUNTS**

### **Federal Trade Commission's Red Flags Rule**

The Federal Trade Commission's (FTC) Red Flags Rule, which implements obligations imposed by the Fair and Accurate Credit Transactions Act of 2003 (FACT Act), requires certain firms to create a written Identity Theft Prevention Program (ITPP) that is designed to identify, detect and respond to "red flags"—patterns, practices or specific activities—that could indicate identity theft. FINRA has developed a new, optional template that firms can use as a guide when fulfilling their requirements under the FTC's Red Flags Rule. The FTC has delayed enforcement of its Red Flags Rule until June 1, 2010.

- [FINRA Information Notice 7/1/09](#): New FTC Red Flags Rule Template
- [FINRA Issue Center: Customer Information Protection](#)
- [Federal Trade Commission](#): Fighting Fraud with the Red Flags Rule: A How-To Guide for Business (March 2009)

## **FINANCE AND OPERATIONS**

### **(New) Consolidated Financial Responsibility Rules**

The SEC approved FINRA's proposed rule change to adopt a new set of financial responsibility rules for the Consolidated FINRA Rulebook. FINRA Rules 4110, 4120, 4130, 4140 and 4521 are new consolidated rules governing financial responsibility that are based in part on, and replace, provisions in the NASD and Incorporated NYSE Rules. The rule change also amends FINRA Rules 9557 and 9559 to, among other things, provide firms served with a notice under the financial responsibility rules an expedited appeal process, and makes certain conforming revisions to Section 4(g) of Schedule A to the FINRA By-Laws. The rule change took effect on February 8, 2010. (*See also* Customer Margin Balance Form below.)

- [FINRA Regulatory Notice 09-71](#): SEC Approves Consolidated FINRA Rules Governing Financial Responsibility (December 2009)



## **(Update) Financial Statements Must Be Certified By Auditors Registered With the Public Company Accounting Oversight Board**

Firms are reminded that their auditor must be registered with the Public Company Accounting Oversight Board (PCAOB). Since SEC registration relief expired December 31, 2008, firms must file financial statements certified by a PCAOB-registered auditor for their fiscal years ending after that date. Firms are further reminded that FINRA will treat financial statements certified by an auditor that is not PCAOB-registered as not having been filed under Section 4(g) of Schedule A to the FINRA By-Laws.

- [FINRA Information Notice 12/9/2009](#): Certification of Annual Audits
- [FINRA Information Notice 1/8/2009](#): Public Company Accounting Oversight Board Relief

## **FDIC Guaranteed Debt**

FINRA advised firms of the Net Capital and Reserve Formula treatment of senior unsecured debt securities issued under the Debt Guarantee Program component of the Federal Deposit Insurance Corporation's (FDIC) Temporary Liquidity Guarantee Program.

- [FINRA Regulatory Notice 09-38](#): Guidance on the Net Capital and Reserve Formula Treatment of Senior Unsecured Debt Securities Issued Under the Debt Guarantee Program Component of the FDIC's Temporary Liquidity Guarantee Program (July 2009)

## **INSURANCE/ANNUITIES**

### **(Update) Deferred Variable Annuities**

FINRA Rule 2330 establishes broker recommendation requirements (including suitability and disclosure obligations), principal review requirements, supervisory procedure requirements and training requirements. The implementation date of the FINRA rule - as well as previously approved amendments to parts of the rule covering principal review and supervisory procedures—was February 8, 2010. *Regulatory Notice 10-05* addresses issues raised about a firm's ability to hold



checks made payable to entities other than itself (third parties) pursuant to interpretive relief that FINRA previously issued.

- [FINRA Regulatory Notice 10-05](#): FINRA Reminds Firms of Their Responsibilities Under FINRA Rule 2330 for Recommended Purchases or Exchanges of Deferred Variable Annuities (January 2010)

A more in-depth discussion of the amendments regarding principal review and supervisory procedures under the rule on deferred variable annuities is provided in *Regulatory Notice 09-32*. Among other things, the amendments limited the rule's application to recommended transactions, changed the triggering event that begins the principal review period, and clarified various other issues through supplementary material to the rule.

- [FINRA Regulatory Notice 09-32](#): SEC Approves Amendments to NASD Rule 2821 Governing Purchases and Exchanges of Deferred Variable Annuities (June 2009)
- [FINRA Regulatory Notice 09-72](#): SEC Approval and Effective Dates for New Consolidated FINRA Rules (December 2009)
- [FINRA Issue Center](#): Variable Annuities

## Variable Contracts

FINRA Rule 2320 regulates member firms in connection with the sale and distribution of variable life insurance and variable annuity contracts (together, variable contracts). It prohibits firms from participating in the offer or sale of a variable contract unless certain conditions are met. It also regulates member compensation in connection with the sale and distribution of variable contracts, including both cash and non-cash compensation arrangements.

- [FINRA Regulatory Notice 09-50](#): SEC Approval and Effective Dates for New Consolidated FINRA Rules (September 2009)

## Variable 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. Member firms and associated persons are reminded that life



settlements involving variable insurance policies are securities transactions, and firms and associated persons involved in such transactions are subject to applicable FINRA rules.

- [FINRA Regulatory Notice 09-42](#): FINRA Reminds Firms of Their Obligations With Variable Life Settlement Activities (July 2009)

## **MARGIN AND MARGIN ACCOUNTS**

### **(New) Customer Margin Balance Form**

In February 2010, FINRA announced that, beginning March 1, 2010, members subject to new FINRA Rule 4521(d) are required to file FINRA's new Customer Margin Balance Form. FINRA reminded firms that FINRA Rule 4521(d) governs filing requirements for customer margin accounts and took effect on February 8, 2010. The rule, adopted as part of the new consolidated financial responsibility rules, replaces Incorporated NYSE Rules 421(2) and 421.40 and applies to all FINRA members that carry customer margin accounts. (*See also* Consolidated Financial Responsibility Rules above).

- [FINRA Regulatory Notice 10-08](#): Filing Requirements for Members that Carry Customer Margin Accounts; New Customer Margin Balance Form (February 2010)

### **(New) Alternative Margin Treatment for Call Writes against Employee Stock Options**

On June 17, 2009, the SEC approved CBOE customer margin rules that provide for spread margin treatment on the writing of listed equity call options when, for the same underlying security and underlying quantity of shares, the writer owns employee stock options that are vested and exercisable (vested and exercisable employee stock option or VESO).

- [CBOE Regulatory Circular RG09-141](#): Alternative Margin Treatment Available for Writing Listed Equity Call Options Against Employee Stock Options (December 2009)



## ***(Update)* Margin Requirements for Leveraged ETFs**

The customer margin requirements for leveraged ETFs have increased effective December 1, 2009. The customer margin requirements for uncovered options overlying leveraged ETFs, as well as the application of day-trading margin requirements for leveraged ETFs, are scheduled to increase on April 30, 2010.

- [\*\*FINRA Regulatory Notice 09-65\*\*](#): FINRA Delays the Effective Date for Increased Margin Requirements for Options on Leveraged ETFs and Day-Trading Requirements for Leveraged ETFs (November 2009)
- [\*\*CBOE Regulatory Circular RG09-132\*\*](#): Update of RG09-097, Margin Requirements for Leveraged ETFs and Uncovered Options on Leveraged ETFs (November 2009)
- [\*\*CBOE Regulatory Circular RG09-097\*\*](#): Margin Requirements for Leveraged ETFs and Uncovered Options on Leveraged ETFs (August 2009)
- [\*\*FINRA Regulatory Notice 09-53\*\*](#): Increased Margin Requirements for Leveraged Exchange-Traded Funds and Associated Uncovered Options (August 2009)

## **Margin Requirements for Credit Default Swaps**

In May 2009, the SEC approved FINRA Rule 4240, which established an interim pilot program (the Interim Pilot Program) with respect to margin requirements for transactions in credit default swaps (CDS) executed by members. The rule, which went into effect on June 3, 2009, also sets forth risk monitoring procedures and guidelines. The Interim Pilot Program's requirements extend to any transactions in CDS executed by a member firm (regardless of the type of account in which the transaction is booked), including those in which the offsetting matching hedging transactions are effected by the firm in CDS contracts that are cleared through the central counterparty clearing services of the Chicago Mercantile Exchange (CME). The Interim Pilot Program is in effect through November 30, 2010 (pursuant to SR-FINRA-2009-063, the program was extended from the original expiration date of September 25, 2009).



- [FINRA Regulatory Notice 09-30](#): SEC Approves Rule Establishing an Interim Pilot Program on Margin Requirements for Transactions in Credit Default Swaps (June 2009)

## **MUNICIPAL SECURITIES**

### **Auction Rate Securities**

In light of downgrades of municipal bond insurers, other short-term liquidity concerns creating extreme market volatility for municipal and other auction rate securities (ARS), an unprecedented number of “failed auctions,” and several settlements, FINRA and the MSRB have issued several notices pertaining to disclosures, margin, transaction reporting, reporting of customer complaints, and suitability requirements as well as guidance regarding the allocation of redemptions in a partial redemption of auction rate securities and other securities.

- [FINRA Regulatory Notice 09-12](#): Reporting Requirements for Settlements of Customer Disputes Involving Auction Rate Securities (February 2009)
- [MSRB Notice 2008-36](#): Transaction Reporting of Dealer Buybacks of Auction Rate Securities: Rule G-14 (September 2008)
- [FINRA Regulatory Notice 08-21](#): FINRA Issues Guidance to Broker-Dealers on Partial Redemptions of Auction Rate Securities (April 2008)
- [FINRA Regulatory Notice 08-17](#): Reporting of Customer Complaints Relating to Auction Rate Securities (April 2008)
- [FINRA Regulatory Notice 08-08](#): FINRA Temporarily Increases Margin Maintenance Requirements on Auction Rate Securities Backed by Fixed Income Products (March 2008)
- [MSRB Notice 2008-09](#): Application of MSRB Rules to Transactions in Auction Rate Securities (February 2008)

The SEC approved amendments to MSRB Rule G-34 that require brokers, dealers and municipal securities dealers to report the reset interest rate and other descriptive information regarding ARS and variable rate demand obligations



(VRDOs) to the MSRB using a new MSRB electronic system, the Short Term Obligation Rate Transparency System (SHORT).

- [MSRB Notice 2009-04](#): SEC Approves Proposal to Increase Transparency of Auction Rate Securities and Variable Rate Demand Obligations (January 2009)

On April 28, 2009, the MSRB filed a rule change for immediate effectiveness amending MSRB Rule G-8 that requires dealers involved in ARSs and VRDOs to keep specific additional records regarding such activities and SHORT reporting.

- [MSRB Notice 2009-16](#): Notice of Filing of Amendment to Rule G-8, On Books and Records, Relating to Auction Rate Securities and Variable Rate Demand Obligations (April 2009)
- [MSRB Notice 2008-04](#): Bond Insurance Ratings—Application of MSRB Rules (January 2008)

## California IOUs

The SEC issued guidance stating that registered warrants (also known as IOUs) issued by the state of California are municipal securities; therefore, persons acting as intermediaries between buyers and sellers of these warrants must be appropriately registered. All dealers that sell or trade municipal securities must be registered with the MSRB and must comply with MSRB rules on professionalism and fair practice.

- [MSRB Notice 2009-41](#): Applicability of MSRB Rules to California Registered Warrants (July 2009)

The MSRB reminds dealers that they must comply with the fair practice obligations under Rule G-17 in their municipal securities activities with issuers of municipal securities. The duty to an issuer extends to all municipal securities activities, such as representations made to an issuer regarding investors during an underwriting (*e.g.*, regarding retail investors and retail order periods), and certain payments made and expenses reimbursed for excessive or lavish entertainment or travel expenses in connection with an issuance.

- [MSRB Notice 2009-54](#): Reminder Notice of Fair Practice Duties to Issuers of Municipal Securities (September 2009)



## Electronic Municipal Market Access System

The MSRB has implemented an all-electronic standard for free public access to primary market disclosure information and transaction information for the municipal securities market. Effective June 1, 2009, all submissions by underwriters of official statements (OSs) and advance refunding documents (ARDs) to the MSRB formerly made under Rule G-36 shall be made under revised Rule G-32, on disclosures in connection with primary offerings, through the Electronic Municipal Market Access (EMMA) primary market disclosure service. Under certain circumstances, an underwriter's obligation to deliver an official statement to a customer who purchases municipal securities may be satisfied if the underwriter has made required submissions to EMMA.

Effective July 1, 2009, the MSRB implemented a permanent continuing disclosure service through EMMA, accepting continuing disclosure documents and related information from issuers, obligated persons and their agents pursuant to continuing disclosure undertakings entered that are consistent with Exchange Act Rule 15c2-12 and other continuing disclosures that are voluntary submissions. Public access to this information is provided free of charge on EMMA.

EMMA is accessible at [www.msrb.org](http://www.msrb.org) or [www.emma.msrb.org](http://www.emma.msrb.org).

- [\*\*MSRB Notice 2009-28\*\*](#): MSRB Establishes Electronic Official Statement Dissemination Standard under Rule G-32 and Launches Permanent Primary Market Disclosure Service of EMMA (June 2009)
- [\*\*MSRB Notice 2009-39\*\*](#): MSRB Launches the Continuing Disclosure Service of its Electronic Municipal Market Access System ("EMMA") (July 2009)

FINRA recommends that firms engaged in municipal securities business review, and if necessary, modify their existing policies and procedures to comply with changes in the MSRB EMMA system that took effect on July 1, 2009 and changes to MSRB rules that took effect on June 1, 2009.

- [\*\*FINRA Regulatory Notice 09-35\*\*](#): FINRA Recommends Review of Municipal Securities Activities (June 2009)



## Municipal Securities Supervisory Requirements

MSRB has filed with the SEC for immediate effectiveness guidance on disclosure, suitability of recommendations, fair pricing and other sales practice obligations by broker-dealers to individual and other retail investors in municipal securities. When effecting a transaction, a dealer has an obligation under MSRB Rule G-17 to disclose to its customer all material information about the transaction known by the dealer as well as material information about the security that is reasonably accessible to the market. Among other things, the amount, nature, timing and accessibility of information available to the dealer and the entire marketplace have changed significantly since 2002 and, in particular, with the advent of MSRB's EMMA system and price transparency.

- [MSRB Notice 2009-42](#): MSRB Issues Interpretive Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities. (July 2009)

## New Issue Municipal Securities

The American Recovery and Reinvestment Act of 2009 added provisions to the Internal Revenue Code authorizing state and local governments to issue two types of Build America Bonds – Build America Bonds (Tax Credit) and Build America Bonds (Direct Payment). These bonds are municipal bonds, and dealers engaged in municipal securities business activities in connection with these bonds are subject to all MSRB rules, including appropriate professional qualifications and supervision, underwriting, reporting, confirmation of transactions to customers, political contributions, the payment of MSRB underwriting and transaction assessment fees, automated clearance and settlement, etc. With regard to political contributions, dealers may wish to note that the making of presentations to potential issuers of Build America Bonds or other tax credit bonds would be considered a solicitation of municipal securities business. Personnel participating in such activity would be considered municipal finance professionals (MFPs) of the dealer under Rule G-37, even if such personnel are employed in divisions or departments of the dealer that do not traditionally engage in municipal securities business.

- [MSRB Notice 2009-15](#): Build America Bonds and Other Tax Credit Bonds (April 2009)
- [MSRB Notice 2009-30](#): Application of Rule G-37 to Solicitations of



Issuers (June 2009)

- [MSRB Notice 2009-49](#): Build America Bonds: Reminder of Rule G-15(a) Customer Confirmation Yield Disclosure Requirement (August 2009)

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

The MSRB has published an interpretive letter regarding the activities of a broker-dealer that is engaged in soliciting municipal securities business on behalf of an affiliated company.

- [MSRB Notice 2009-40](#): MSRB Publishes Interpretive Letter Regarding Solicitation Activity on Behalf of an Affiliated Company Pursuant to Rules G-37 and G-38 (July 2009)

The SEC has approved changes to MSRB Rule G-37 that require the public disclosure of certain contributions made to bond ballot campaigns by dealers, their political action committees, MFPs and non-MFP executive officers. Dealers are also required to create and maintain records of contributions to bond ballot campaigns. The amendments became effective on February 1, 2010.

- [MSRB Notice 2010-01](#): SEC Approves Amendments to Rule G-37 and Rule G-8 Relating to Political Contributions (January 22, 2010)

## **OPTIONS**

### **Options Symbology**

Execution of the symbol consolidation strategy under the [Options Symbology Initiative \(OSI\)](#) will take place between March 2010 and May 2010.

### ***(Update)* Options Disclosure Document**

On December 10, 2009, the SEC approved a supplement to the [Options Disclosure Document \(ODD\)](#). The ODD contains general disclosures on the characteristics and risks of trading standardized options. This supplement adds disclosure regarding the characteristics and special risks of dividend index options. It also adds disclosure stating that the options markets may use methods other than those specified in the ODD to set exercise prices. As with other



supplements to the ODD, this should be read in conjunction with the current ODD entitled Characteristics and Risks of Standardized Options. This supplement supersedes and replaces the September 2008 supplement to the ODD, which relates to selected index options.

- [FINRA Information Notice 12/29/2009](#): Supplement to the Options Disclosure Document
- [CBOE Regulatory Circular RG10-07](#): Supplement to the Options Disclosure Document (January 2010)

## Options Communications Rules

In August 2009, the SEC approved the adoption of NASD Rule 2220 (Options Communications) without substantive change into the Consolidated FINRA Rulebook as FINRA Rule 2220. FINRA Rule 2220 took effect on December 14, 2009. The SEC has also approved similar changes to CBOE Rule 9.21, Communications to Customers.

- [FINRA Regulatory Notice 09-60](#): SEC Approval and Effective Dates for New Consolidated FINRA Rules (October 2009)
- [FINRA Regulatory Notice 08-73](#): SEC Approves Amendments to NASD Rule 2220 to Update the Standards for Options Communications (December 2008)
- [CBOE Regulatory Circular RG08-155](#): Revisions to Options Communications Rules (November 2008)

## REGISTRATION AND DISCLOSURE

### **(New) BrokerCheck<sup>®</sup>**

Beginning November 30, 2009, information concerning final regulatory actions against brokers—as well as certain administrative information (*e.g.*, employment and registration history) and information about qualification examinations, if available, and the broker's most recently submitted comment, if any—will be permanently available in BrokerCheck, regardless of when they were employed in the securities industry.



- [FINRA Regulatory Notice 09-66](#): SEC Approves Changes to FINRA's BrokerCheck Disclosure Rule to Retain and Make Publicly Available Information About Final Regulatory Actions Against Former Brokers (November 2009)

## Eligibility Proceedings

The FINRA Rule 9520 Series sets forth eligibility proceedings under which FINRA may allow a person subject to a statutory disqualification to enter or remain in the securities industry. Effective June 15, 2009, amendments to the FINRA Rule 9520 Series address the circumstances under which persons subject to certain statutory disqualifications must obtain FINRA approval to enter or remain in the securities industry.

- [FINRA Regulatory Notice 09-19](#): Amendments to FINRA Rule 9520 Series to Establish Procedures Applicable to Firms and Associated Persons Subject to Certain Statutory Disqualifications (April 2009)

## Revised Forms U4 and U5

The SEC approved amendments to Forms U4 and U5 as well as FINRA Rule 8312 (FINRA BrokerCheck Disclosure). The amendments include, among other things, significant changes to disclosure questions on the Forms, including the addition of questions about certain regulatory actions; new questions that require firms to report allegations of sales practice violations made against a registered person in an arbitration or litigation in which the registered person is not a named party; and an increase in the monetary threshold for reporting settlements of customer complaints, arbitrations or litigations from \$10,000 to \$15,000. The amendments took effect on May 19, 2009, except for the disclosure questions regarding regulatory actions, which took effect on November 14, 2009.

- [FINRA Regulatory Notice 09-23](#): SEC Approval of Proposed Changes to Forms U4 and U5 and FINRA Rule 8312 (FINRA BrokerCheck Disclosure) (May 2009)

In addition, FINRA offers a webcast that explains the process for submitting Form U4 and Form U5 filings.

- [What to Expect: The U4 and U5 Filing Process](#)



## Record Retention Requirements for Uniform Forms

FINRA member firms can rely on Web CRD to satisfy their record retention requirements with respect to certain Forms U4, U5 and BR filed in Web CRD, provided they adhere to the terms of the no-action relief granted by the staff of the SEC.

- [FINRA Information Notice February 21, 2008](#): FINRA Secures Relief for Member Firms for Certain Record Retention Requirements (February 2008)

The SEC approved the adoption of NASD Rule 1140, subject to certain amendments, into the Consolidated FINRA Rulebook as FINRA Rule 1010 (Electronic Filing Requirements for Uniform Forms). FINRA Rule 1010 supports the information reported by firms to Web CRD and, among other things, permits firms to file amendments to Form U4 disclosure information without obtaining the associated person's manual signature, provided that the firm uses reasonable efforts to:

- provide the registered person with a copy of the amended disclosure information prior to filing; and
- obtain the registered person's written acknowledgment (which may be electronic) prior to filing that the information has been received and reviewed subject to certain specified conditions.

Additionally, the SEC approved the adoption of NASD Rule 3080, subject to minor amendments, into the Consolidated FINRA Rulebook as FINRA Rule 2263 (Arbitration Disclosure to Associated Persons Signing or Acknowledging Form U4). As with NASD Rule 3080, FINRA Rule 2263 requires firms to provide each associated person with arbitration disclosures whenever the firm asks an associated person, pursuant to FINRA Rule 1010, to manually sign a new or amended Form U4, or to otherwise provide written acknowledgment of an amendment to the Form U4. FINRA Rule 1010 took effect on July 27, 2009, and FINRA Rule 2263 took effect on September 25, 2009.

- [FINRA Regulatory Notice 09-40](#): SEC Approval and Effective Dates for New Consolidated FINRA Rules on Electronic Filing Requirements for Uniform Forms and Arbitration Disclosures (July 2009)



## **RESEARCH**

### **Trading Ahead of Research Reports**

The SEC approved FINRA Rule 5280 (Trading Ahead of Research Reports) as part of the Consolidated FINRA Rulebook. The rule, which contains certain modifications to previous NASD Interpretive Material, became effective on April 20, 2009.

- [FINRA Regulatory Notice 09-11](#): SEC Approval and Effective Date for New Consolidated FINRA Rule on Trading Ahead of Research Reports (February 2009)

## **SALES PRACTICES AND SUPERVISION**

### **Annual Reporting**

CBOE reminds its members and member firms of the requirement to submit a written report by April 1 of each year that details the member organization's supervision and compliance effort and report on the member organization's ongoing compliance processes and procedures.

- [CBOE Regulatory Circular RG08-168](#): Annual Reporting Pursuant to CBOE Rule 9.8 – Supervision of Accounts (December 2008)

MSRB filed with the SEC for immediate effectiveness guidance on disclosure and other sales practice obligations by broker-dealers to individual and other retail investors in municipal securities.

- [MSRB Notice 2009-42](#): MSRB Issues Interpretive Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities (July 2009)

### **Designations**

Regulators have sought to address concerns relating to the proliferation of professional designations, including those that require no meaningful training or specialized knowledge but suggest an expertise in retirement planning or financial services for seniors.



- [NASAA Model Rule](#): Use of Senior-Specific Certifications and Professional Designations (March 2008)
- [FINRA Regulatory Notice 07-43](#): FINRA Reminds Firms of Their Obligations Relating to Senior Investors and Highlights Industry Practices to Serve these Customers (September 2007)
- [FINRA Investor Information](#): Understanding Professional Designations

## **SHORT SALES**

### ***(New)* Amendments to SEC Regulation SHO**

On February 24, 2010, the SEC adopted amendments to Regulation SHO to, among other things, implement an alternative uptick rule (new Rule 201). Rule 201 imposes restrictions on short selling whenever the price of a covered security declines by 10 percent or more from the prior day's close, in which case a circuit breaker is triggered for that security restricting short sales at any price less than or equal to the current national best bid in that security for the remainder of the day and the following day. The rule requires trading centers to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent the execution or display of a prohibited short sale. Rule 201 becomes effective on May 10, 2010 with a compliance date of November 10, 2010.

### **Short Sales, Temporary Rule 204T of Regulation SHO Now Permanent**

On July 27, 2009, the SEC issued an order making interim final temporary Rule 204T of Regulation SHO permanent, effective as of July 31, 2009 (the date on which Rule 204T was set to expire). Rule 204T sets out specific requirements to promptly purchase or borrow securities to deliver on long and short sales. The new rule (Rule 204) maintains the structure of Rule 204T with some modifications. In addition, the SEC's order notes that volume weighted average price (VWAP) orders may be utilized to close-out fails to deliver. A VWAP order must be irrevocable, received by no later than the beginning of regular trading hours on the applicable close-out date, have a final execution price that is determined after the close of regular trading hours when the VWAP value is calculated and be executed on an agency basis.



- [CBOE Regulatory Circular RG09-83](#): Short Sales, Temporary Rule 204T of Regulation SHO now permanent (August 11, 2009)
- [SEC Division of Market Regulation](#): Responses to Frequently Asked Questions Concerning Regulation SHO (Updated 8/28/2009)

## **TRADING PRACTICES AND SUPERVISION**

### ***(New)* Clearly Erroneous Trades**

The new FINRA Rule 11890 Series, which governs clearly erroneous transactions, replaces NASD Rule 11890, IM-11890-1 and IM-11890-2 and was adopted as part of a market-wide effort by multiple SROs to provide transparency and finality with respect to clearly erroneous executions. Among other things, the new rule series includes a new general rule defining "clearly erroneous" transactions, separate provisions for the determination of clearly erroneous transactions depending upon whether the transaction involves an exchange-listed security or an over-the-counter equity security and procedures for appealing FINRA clearly erroneous determinations. In addition, the new rule series codifies minimum numerical criteria necessary for a transaction to qualify as clearly erroneous.

- [FINRA Regulatory Notice 10-04](#): SEC Approves Consolidated FINRA Rules Governing Clearly Erroneous Transactions (January 2010)

### **Handling of Large Orders**

NYSE Regulation issued regulatory guidance on supervising the handling of large orders, which can raise regulatory concerns. These concerns include potential conflicts of interest, best execution obligations, manipulation and special considerations relating to trading strategies and benchmarks revolving around the closing price of a security.

- [NYSE Regulation Information Memo 09-40](#): Regulatory Guidance on Handling of Large Orders (August 2009)



## Indications of Interest

FINRA reminded firms of their obligations to communicate accurate information when disseminating, or using services to disseminate indications of interest to the marketplace.

- [FINRA Regulatory Notice 09-28](#): FINRA Reminds Firms of Their Obligations to Provide Accurate Information in Disseminating, or Using Services to Disseminate, Indications of Interest (May 2009)

## TRANSACTION REPORTING AND DATA DISSEMINATION

### Alternative Trading Systems

FINRA reminded firms that are alternative trading systems or operate alternative trading systems that, in addition to filing all reports required by Regulation ATS with the SEC, they also must simultaneously file duplicate copies of most reports with FINRA.

- [FINRA Regulatory Notice 09-46](#): FINRA Reminds Alternative Trading Systems of Their Reporting Obligations (August 2009)

### Trade Reporting and Compliance Engine (TRACE)

Effective March 1, 2010, the definition of TRACE-Eligible Security was expanded to include Agency Debt Securities, requiring firms to report transactions in such securities. For purposes of TRACE, Agency Debt Securities are debt securities that are issued or guaranteed by a U.S. agency (Agency) or a government-sponsored enterprise (GSE). The term Agency is broadly defined. Agency Debt Securities do not include U.S. Treasury securities. In addition, the amendments require firms to report primary market transaction in TRACE-Eligible Securities. Previously, firms were required to report secondary market transactions only. Firms must comply with all requirements of the FINRA Rule 6700 Series regarding Agency Debt Securities that are now TRACE-Eligible Securities and FINRA Rule 7730 regarding fees.

- [FINRA Regulatory Notice 09-57](#): SEC Approves Amendments Expanding TRACE to Include Agency Debt Securities and Primary Market Transactions (September 2009)



Effective June 15, 2009, the definition of TRACE-Eligible Security was broadened with the deletion of the following two requirements: (1) that TRACE-Eligible Securities be registered under the Securities Act of 1933; and (2) with respect to securities that are resold in a Securities Act Rule 144A transaction, that such securities initially be offered and sold under the exemption from registration in Section 4(2) of the Securities Act.

- [FINRA Regulatory Notice 09-24](#): SEC Approves Amendments Expanding the Definition of “TRACE-Eligible Security” (May 2009)

### **Trade Reporting Structure for Equity Securities**

Effective August 3, 2009, firms' trade reporting obligations for over-the-counter (OTC) equity transactions were changed. Specifically, FINRA trade reporting rules were amended to (1) replace the current market maker-based trade reporting structure with an "executing party" structure; and (2) require firms with the trade reporting obligation that are acting in a riskless principal or agency capacity on behalf of another member firm(s) to submit non-tape report(s) to FINRA, as necessary, to identify such other firm(s) as a party to the trade.

- [FINRA Regulatory Notice 09-08](#): SEC Approves Amendments to FINRA Trade Reporting Rules (January 2009)

### ***(Update)* Related Market Center**

FINRA has extended to May 3, 2010, the effective date of rule amendments that require firms to identify the Related Market Center in non-tape reports submitted to a FINRA trade reporting facility.

- [FINRA Trade Reporting Notice 2/8/10](#): FINRA Extends Implementation of Amendments Requiring Related Market Center Indicator in Non-Tape Reports Submitted to FINRA. (This *Notice* supplements, and should be read in conjunction with, *Regulatory Notice 09-54* (September 2009)).



## Trade Reporting Frequently Asked Questions

FINRA publishes on its Web site Trade Reporting Frequently Asked Questions (FAQ), which provide guidance for firms on reporting OTC transactions in equity securities to a FINRA Facility (*i.e.*, a Trade Reporting Facility (TRF), the Alternative Display Facility (ADF) or the OTC Reporting Facility (ORF)). Firms should be aware of and review these FAQs, which FINRA updates periodically.

- [FINRA Trade Reporting Notice 8/14/08](#): Trade Reporting Frequently Asked Questions



## More Information

Contact CE Council members for more information:

Regulatory Organization	Web Site
Chicago Board Options Exchange	<a href="http://www.cboe.com">www.cboe.com</a>
FINRA	<a href="http://www.finra.org">www.finra.org</a>
Municipal Securities Rulemaking Board	<a href="http://www.msrb.org">www.msrb.org</a>
North American Securities Administrators Association	<a href="http://www.nasaa.org">www.nasaa.org</a>
U.S. Securities and Exchange Commission	<a href="http://www.sec.gov">www.sec.gov</a>