

# **Content Outline for the S106 Regulatory Element Program**

## **Introduction**

The S106 Regulatory Element Program is required for Series 6 registered persons. The content for the S106 is organized into four modules, and includes common topics that may be covered in any of the four modules. The content coverage of each of these modules and the common topics are outlined following this introduction. Unless otherwise specified, the topics are covered at basic levels of knowledge and understanding.

The Securities Industry Continuing Education Program (CE Program), which is required by the rules of several self-regulatory organizations (SRO), is a two-part program composed of a Regulatory Element and a Firm Element. The Regulatory Element is developed by industry committees representing a diverse range of broker-dealers, in conjunction with the Securities Industry/Regulatory Council on Continuing Education, industry regulatory agencies and SROs. The Firm Element is developed and must be delivered by each firm on an annual basis. The CE Program is intended to keep registered securities industry personnel current regarding rules and other issues important to performing their jobs appropriately.

## **The Regulatory Element**

The Regulatory Element requires all registered persons to participate in a prescribed computer-based training session within 120 calendar days of their second registration anniversary date and every three years thereafter. Failure to complete the Regulatory Element within 120 days of the prescribed anniversary date will result in a person's registration becoming inactive. The Regulatory Element is designed to cover significant subject matter that is broadly applicable to all registered persons.

The Regulatory Element focuses on compliance, regulatory, ethical and sales-practice standards. Its content is derived from rules and regulations, as well as standards and practices widely accepted within the industry. Although the specific requirements of certain rules may differ slightly among the various SROs, the program is based on standards and principles applicable to all. In certain instances, particular SRO requirements may be more restrictive than those represented in the Regulatory Element. Additionally, broker-dealers may have policies and procedures that are more restrictive than industry regulations regarding the types of activities in which their registered employees may engage, the investment products they may represent, and/or specific approvals required for certain functions. Registered persons and their supervisors are responsible for ensuring that their activities are within the scope permitted by their employing broker-dealers and conducted in accordance with the rule requirements of all of the SROs and jurisdictions regulating them.

Please note that individuals may choose to view a sample case and an orientation for the Regulatory Element. The sample case and orientation are provided as resources to those who would like to familiarize themselves with the program format and features. Those required to

take the Regulatory Element are encouraged to review the sample case and orientation prior to taking for their session.

Candidates currently eligible to take the program can do so online by clicking this link to [FINRA.org](http://FINRA.org).

### ***Presentation of the Training***

In each module participants are led through a case that provides a story depicting situations that may be faced by registered persons in the course of their business. Each case contains significant educational content, including material called Resources and Glossary Rollovers. Participants must review the story content of each case but may choose whether to utilize the optional materials. Participants are encouraged to utilize all of the educational content provided in the S106, including the optional material, as it is designed to aid understanding and enhance the educational experience for the participant.

The format of the cases in the S106 Program is primarily text-based with some media treatments that provide important information, context and education related to the story.

### ***Assessment, Proficiency and Timing***

As part of each case, participants are presented a series of questions. These questions, which relate to the story and facts presented in the case, are designed to assess the participant's understanding of the materials presented.

Participants must demonstrate their understanding of the subject matter by choosing the most appropriate response(s) to questions. Participants must demonstrate proficiency in each of the four modules of the S106. Participants that do not demonstrate proficiency with the subject matter will cycle through cases within the same module until proficiency is achieved.

# Content Outline

## **Module A: Communications with the Public**

### **A.1 Types of Communications**

#### **A.1.1 Written and Electronic Communications**

- Definition, use, approval requirements, and retention requirements for written communications, including:
  - Correspondence
  - Advertising
  - Sales Literature
  - Institutional investor communications
  - Electronic communications including email, websites (including links to other sites), text messaging, instant messaging, weblogs (blogs), podcasts, webcasts, online bulletin boards or postings, social networking websites, and other electronic means.
- Restrictions and use of confidential material, including internal-use-only and broker-dealer-use-only materials.

#### **A.1.2 Oral and Other Communications**

- Approval, record retention, and other requirements for seminars, public speaking engagements, and communications in and with the press.
- Restrictions on telephone solicitations including, but not limited to: cold calling/telemarketing, prospecting, broker-dealer Do-Not-Call lists, state Do-Not-Call lists, and the National Do-Not-Call Registry.
- Requirements and best practices pertaining to the use of scripts.
- Prohibitions regarding high-pressure and deceptive sales tactics.

### **A.2 Standards for Review and Approval of Communications**

- Responsibilities and permissible activities for registered and unregistered persons.
- Responsibility to provide fair and balanced presentations of products and/or services offered.
- Requirements for the broker-dealer to maintain records of communications and to comply with firm policies to support the requirement.

- Approval requirements.
  - General and specific approval requirements (firm and regulatory) for communications.
  
- Required disclosures and restrictions for communications with the public.
  - Use of testimonials.
  - Product-specific disclosures.
  - Sponsors and/or compensation received for communications.
  - Requirements for written investment recommendations.
  - Requirements and permitted activities associated with research reports.
    - Required disclosures.
    - Restrictions on use of research.
    - Distribution of broker-dealer and third-party research reports.
  - Disclosure and standards for communications distributed exclusively to institutional investors.
  - Restrictions and permission requirements when distributing copyrighted materials.
  
- Prohibitions against certain activities.
  - Prohibition on conducting communications through means that are not approved or retained by the broker-dealer.
  - Regulations prohibiting the guaranteeing of investment performance.
  - Prohibitions against making blanket recommendations.

## **Module B: Suitability**

### **B.1 Customer Information**

- Obtaining customer financial information including, at a minimum, net worth, income, liquid assets, and tax status.
  
- Gathering customer profile data such as marital status, date of birth, number of dependents, employment information and other relevant information.
  
- Confirming customer information within 30 days of account opening.

- Determining risk tolerance, investment objectives, time horizon, and investment experience.

## **B.2 Concepts and Implications Related to Risk**

- Specific responsibilities of the Registered Representative (RR) when recommending investments.
  - Understanding the characteristics and risks associated with products offered and investments recommended.
  - Disclosure and explanation of risks associated with recommendations.
  - Making recommendations that are suitable for the customer.
- Types, potential implications, and examples of risk. These risks may include, but are not limited to: call risk, concentration risk, credit risk, emerging market risk, interest rate risk, legislative risk, liquidity risk, market risk, purchasing power risk (inflation risk), reinvestment risk, principal risk, currency risk, political risk, sector risk, sovereign risk.
- Characteristics and risks of investment products, including, but not limited to,
  - Municipal fund securities (529 College Savings Plans)
  - Mutual Funds
  - Unit Investment Trusts (UITs)
  - Variable Annuities and Variable Life Insurance Contracts
  - Exchange Traded Funds (ETFs)
  - Real Estate Investment Trusts (REITs)
  - 401(k) Plans
  - Individual Retirement Accounts (IRAs)
  - Defined Benefit Plans.

## **B.3 Monitor Customers' Information and Accounts**

- Periodically monitor and update customers' financial information, profile, risk tolerance, investment objectives and investment holdings through regular communication with customers.
- Support the firm's requirement to record and confirm changes with the customer by promptly recording and reporting changes for customer account information.

- Determine suitability of an investment before making recommendations to customers.
  - Consideration of customer objectives, risk tolerance, time horizon, changes in circumstances, holdings, and other applicable information.
  - Understanding and applying principles of diversification.
  - Heightened suitability standards for senior investors.

## **Module C: Handling Customer Accounts, Trade & Settlement Practices**

### **C.1 Account Opening, Customer Identification Program, and Customer Account Information**

- Procedures for opening customer accounts, including required approvals, recordkeeping, and verification of customer identity.
- Broker-dealer books and records requirements.
- Account transfer procedures and requirements (ACATS).
- Confirmations and account statement requirements.
- Privacy rules.
  - Safeguarding customer nonpublic information.
  - Required initial, annual, and opt-out notifications.
- Use of customers' legal and temporary mailing addresses.

### **C.2 Anti-Money Laundering (AML)**

- Anti-Money Laundering rules and regulations, USA PATRIOT Act, and the Bank Secrecy Act.
- Customer Identification Program (CIP) requirements.
- Definitions and understanding the stages of money laundering (placement, layering, and integration.)
- Potential indicators (“red flags”) of money laundering.
- Cash and cash equivalent reporting requirements, Currency Transaction Reports (CTRs), and Suspicious Activity Reports (SAR).

- Understanding the roles of the Financial Crimes Enforcement Network (FinCEN) and Office of Foreign Assets Control (OFAC), including sanctions, prohibitions and listings (e.g., Specially Designated Nationals List) issued.

### **C.3 Account Restrictions and Prohibited, Fraudulent Practices**

- Definitions, best practices, and rules and regulations relating to improper or prohibited activities, including:
  - Insider trading, tipping, and inappropriate use of material nonpublic information.
  - Forgery, theft, misappropriation of funds, borrowing from/lending to customers, conversion, commingling funds, unauthorized trading, performance guarantees, sharing in or guaranteeing against loss, and disguising beneficial ownership of assets (parking).
  - Selling away, piggybacking/shadowing, selling dividends, selling to breakpoints, churning (excessive trading), improper switching, market manipulation, unfair and excessive pricing, front-running, and market timing.

### **C.4 Trading Authorization**

- Documentation (written, approved instructions) requirements to accept orders from someone other than the account owner.
  - Understanding the differences between limited and full trading authorization.
  - Understanding various Powers of Attorney.
- Discretionary trading/discretionary accounts for retail and institutional customers.
- Time and price discretion.
- Order ticket requirements for discretionary transactions.

### **C.5 Customer Complaints and Dispute Resolution**

- Identifying customer complaints.
- Firm and registered representatives' reporting requirements.
- Documenting customer complaints.
- Responding to requests for information.
- Arbitration process, regulatory reporting, and awards.
- Mediation and negotiated settlements.

- Information disclosed in an RR's disciplinary record and/or Forms U4 and U5.

## **C.6 Customer Account Types**

### **C.6.1 Account Registrations**

- Understanding the purpose and characteristics of account types, including:
  - Individual
  - Corporate
  - Joint Accounts
    - Joint Tenants With Right of Survivorship (JTWROS)
    - Tenants in Common (TIC)
    - Community Property With Right of Survivorship (CPWROS)
  - Transfer on Death (TOD)
  - Custodial Account (UGMA/ UTMA)
  - Trust Accounts (e.g., Revocable, Irrevocable, etc.)
  - Educational funding accounts (e.g., 529 College Savings Plans and pre-paid state tuition plans.)

### **C.6.2 Retirement Accounts**

- Purpose and characteristics of qualified retirement plans, such as defined-benefit plans, profit sharing plans, 401(k) plans, Traditional and Roth Individual Retirement Accounts (IRAs), Non-Spousal inherited IRAs, 403(b) and 457 plans.
- The funding, eligibility, employee coverage, contribution limits, tax advantages and restrictions, rollover/transfer rules, and distribution rules for qualified retirement plans.

### **C.6.3 Investment Companies**

- General characteristics, and the similarities and differences among investment companies, real estate investment trusts, and exchange-traded funds.

#### **C.6.3.1 Management companies**

- Definition, characteristics, structure and operation, underwriter functions (sponsor or distributor), role of custodian, and investment objectives of closed-end investment funds, open-end funds (mutual funds), and Unit Investment Trusts (UITs).

### **C.6.3.2 Exchange-Traded Funds (ETFs)**

- Characteristics, including how they are structured, traded and priced.
- Investment considerations (i.e., risks and benefits) and suitability.

## **C.7 Account Transfers and Customer Records**

- Requirements for conducting account transfers.
  - Automated Customer Account Transfer Service (ACATS).
- Confidentiality issues and responsibilities related to customer accounts and records.
- Procedures following the death of a customer.
- Restrictions, approvals, and disclosure requirements when accepting or paying referral fees.
- Order ticket requirements, including recording transactions as solicited or unsolicited.
- Requirements for conducting transfer or disbursement of funds.

## **C.8 Handling Customer Accounts**

### **C.8.1 Account Administration**

- Understanding and utilizing cost basis.
- Distribution of funds.
- General requirements for payment and trade settlement. Consequences of non-payment and non-delivery.
- Alternatives for non-invested cash (e.g., free credit balances, sweep accounts).

### **C.8.2 Other Product Related Issues**

- Tax consequences for various types of products and accounts.
- Dividends and ex-dividends.
- Reorganization events (e.g., mergers and acquisitions, odd-lot tender, stock splits, etc.).
- Free-look provisions.
- Forward pricing.

### **C.8.3 Pricing and Fees**

- Requirements for disclosing pricing and/or fees relating to commissions, and account service fees.

### **C.8.4 Account Protection**

- Disclosure of, purpose of, and coverage limitations of the Securities Investor Protection Corporation (SIPC).
- Private insurance protection in excess of SIPC coverage.

## **Module D: Product Knowledge**

### **D.1 Investment Companies**

- Characteristics of Unit Investment Trusts (UITs); Closed-end investment companies; Exchange-Traded Funds (ETFs); Real Estate Investment Trusts (REITs), open-ended investment companies; diversified and non-diversified companies.
- Determining suitability for each customer individually.

#### **D.1.2 Mutual Funds**

**D.1.2.1 Types of Mutual Funds**, including but not limited to: stock funds, bond funds, hybrid funds (balanced), money market funds, sector concentrated funds, sector diversified funds, specialty funds.

#### **D.1.2.2 Structure, Operation and Costs:**

- Functions/responsibilities of Board of Directors, investment advisors, underwriters (distributor), custodian and transfer agents
- Systematic investing/withdrawals
- Separate accounts
- Availability of Statement of Additional Information (SAI)
- Net Asset Value (NAV)
- Share Classes
- Sales Charges, including breakpoints and computation of charges
- 12b-1 Fees
- Dollar Cost Averaging
- Contingent Deferred Sales Charges (CDSCs)

### **D.1.2.c Activities, Services and Requirements:**

- Mutual fund exchanges
- Exchange privileges/conversions/redemptions
- Switching
- Rights of Reinstatement
- Letters of Intent (LOI)
- Rights of Accumulation (ROA)
- Prospectus/Prospectus delivery requirements
- Inappropriate sales activities (e.g., late trading, market timing, selling to breakpoints)
- Tax consequences from trading activities by the Investment Company and the investor

### **D.1.2.d Types of Distributions**

- Net investment income
- Capital gains
- Return of capital

## **D.2 529 College Savings Plans**

### **D.2.1 Municipal Fund Securities**

- Characteristics of municipal fund securities (i.e., 529 College Savings Plans, LGIPs)
- Comparison to other types of educational savings accounts (e.g., pre-paid tuition plans)
- Federal and state tax issues
  - Tax treatment of contributions and withdrawals
  - Account ownership
  - Gift tax exclusion amounts and step-up exemptions
  - Rollovers
  - Contribution limits
  - Beneficiary changes
  - Qualified expenses
- Specific requirements for advertisements of municipal fund securities

- Sales practice issues and disclosure requirements (e.g., information on a confirmation, time-of-sale disclosures)
- Qualification, registration, and supervision of individuals selling municipal fund securities
- Comparison of how municipal fund securities differ from registered mutual funds and municipal bonds
- Comparison of municipal fund securities and the underlying investments, and the risks associated with both

### **D.3 Unit Investment Trust (UITs)**

### **D.4 Exchange Traded Funds (ETFs)**

- Restrictions on selling ETFs only on the initial offering; no sales in the after market.

### **D.5 Real Estate investment Trusts (REITs)**

- Restrictions on selling REITs only on the initial offering; no sales in the after market.

### **D.6 Qualified Retirement Plans (See Section C.6.2)**

### **D.7 Variable Annuities and Variable Life**

- Characteristics of variable annuities comparison to fixed annuities.
- Sales charges, surrender charges, fees and related expenses (e.g., mortality and expense charges, administrative fees and underlying fund expense charges).
- Insurance company ratings (stability of the issuer).
- Valuation of a variable annuity contract.
- Sub-accounts/separate accounts.
- Tax treatment of individual, tax-deferred variable annuities.
- Free-look provisions.
- Optional enhanced death benefit and living benefit riders.
- Suitability, disclosures, principal review, and required approvals for IRS 1035 Exchanges.
- Prospectus delivery requirements for variable annuities and variable life contracts.
- Required disclosures, costs and features of bonus annuities.

- Characteristics of variable universal and variable life insurance (fixed and flexible premium types.)

## **E: Common Topics**

**Topics identified in this section of the outline will be integrated into cases presented for each of the four modules noted and outlined above.**

### **E.1 Ethics and Business Conduct**

- Observe high standards of commercial honor, conduct activities in accordance with good business practices, and honor just and equitable principles of trade.
- Restrictions, required approvals, and legal risks associated with private securities transactions.
- Permitted and prohibited outside business activities including issues associated with dual licensing, part-time employment, and conflicts of interest.
  - Required notifications and approvals for outside business activities.
- Rules, regulations and standards governing sharing commissions or compensation.
- Prohibition against compensating unregistered persons and/or non-brokers and/or dealers.
  - Restrictions, approval and disclosure requirements for payment of referral fees to nonaffiliated persons.
- Restrictions on loans to or from customers.
- Prohibitions against as well as understanding and recognizing conflicts of interest and potentially illegal situations.
- Restrictions on giving and receiving gifts and gratuities including supervisory or approval requirements.
- Non-cash compensation and sales contests.
- “Prudent Man” Rule.

## **E.2 Registration and Licensing Requirements**

### **E.2.1. Registration and licensing related issues and requirements for individuals and the broker-dealer**

- Requirements of the self-regulatory organizations (SROs).
- State authority and jurisdiction.
- State registration and licensing requirements for registered persons and broker-dealers.
- Conditions, restrictions and requirements for amending Form U4.
- Restrictions on the activities of RRs.
- Differences between insurance appointments and securities licensing.
- Selling agreements.
- Insurance licensing for variable annuities.
- General requirements and limitations on activities as well as registration and licensing for investment advisers.
- Restrictions on activities of unregistered persons.
- Consequences of violating registration or licensing requirements.
- Understanding Continuing Education requirements including the Regulatory Element and Firm Element.
- Restrictions on offering certain products (i.e. selling REITs and ETFs only on the initial offering, no sales in the after market).

### **E.2.2. Blue-Sky Laws and Registration of Securities**

- Requirements for securities to be registered or exempt in states in which they are being sold.
- Distinction between exempt/nonexempt securities.
- General exemptions from registration.

## **E.3 Reporting and Other Requirements**

### **E.3.1 Securities and Exchange Commission (SEC) and SRO Authority and Investigations**

- Understanding the regulatory structure of the securities industry.
- Jurisdiction of the SEC, SROs, and state regulators.
- Obligations to respond to regulatory inquiries.
- Definition and consequences of statutory disqualification.
- Settlement of employer-employee disputes.

## **References**

The following information is provided to candidates for reference when preparing for the S106 Regulatory Element Continuing Education Program. The list of resources is not comprehensive, but is a *sample* of the many resources available. Many of the websites noted below include references to rules, regulations, and notices, as well as investor and RR education.

Candidates are responsible for preparing for their Regulatory Element Continuing Education session. The Content Outline is maintained by FINRA through coordinated efforts with several SROs and the [Securities Industry/Regulatory Council on Continuing Education](#).

### **Financial Industry Regulatory Authority**

[www.finra.org](http://www.finra.org)

### **Municipal Securities Rulemaking**

#### **Board Rule Book**

[www.msrb.org](http://www.msrb.org)

### **North American Securities Administrators Association**

[www.nasaa.org](http://www.nasaa.org)

### **NYSE Alternext**

[www.amex.com](http://www.amex.com)

### **Securities and Exchange Commission**

[www.sec.gov](http://www.sec.gov)