

NASD NOTICE TO MEMBERS 98-17

SEC Approves New NASD Qualification Requirements And Examination For Equity Traders (Series 55)

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Executive Summary

The Securities and Exchange Commission (SEC) recently approved amendments to the National Association of Securities Dealers, Inc. (NASD[®]) Registration Rules regulating qualifications of representatives who trade equity securities in The Nasdaq Stock MarketSM (Nasdaq[®]) and/or over-the-counter. The new rule language is included at the end of this *Notice*. As of April 1, 1998, the effective date of the rule, such traders will be required to pass the new Limited Representative—Equity Trader Examination (Series 55). This is an “add on” exam, and Equity Traders must also pass or have passed either the General Securities Registered Representative Examination (Series 7)¹ or the Corporate Securities Limited Representative Examination (Series 62). Registered persons who currently are functioning as Equity Traders have a two-year grace period within which to pass the examination, provided the member firm with which they are associated applies for Equity Trader registration within 30 days of the effective date of the rule. There is no “grandfather” provision for this new qualification requirement.

Background

In 1995, NASD Regulation, Inc., staff and the National Business Conduct Committee (NBCC) became concerned about the escalating number of rule violations by traders conducting market making and principal trading functions in both the Nasdaq market and over-the-counter. With the view that better training and qualification of traders was necessary, the Market Surveillance staff conducted an assessment of how traders were prepared to trade or make markets in equity securities. Staff visited member firms and discussed the issue with several senior managers of the NASD, as well as

with several members of the Market Surveillance Committee. All parties supported the establishment of a qualification examination requirement designated specifically for traders of equity securities on Nasdaq and/or over-the-counter. This issue was then addressed by the NASD RegulationSM Membership Committee, which recommended the establishment of a category of registration and a qualifying examination for Nasdaq and OTC equity traders. This recommendation was reviewed and approved by the NASD parent and subsidiary Boards in late 1996 and subsequently filed with the SEC. A task force comprising industry representatives and NASD Regulation/Nasdaq staff completed development of the new qualification examination in early 1997 and has maintained the program's currency pending final approval by the SEC.

Qualification Requirements

The new rule establishes a registration category (ET) and qualification examination (Series 55) for Equity Traders. In the context of this new qualification requirement, the term “equity trader” includes market makers, agency traders, and proprietary traders in equity or convertible debt securities and persons who directly supervise these activities. The inclusion of convertible debt securities reflects the fact that, under certain conditions, convertible debt securities trade similarly to equity securities and many of the same regulatory issues and concerns apply to trading in both types of securities. The Equity Trader category does NOT include traders whose primary activities are executing orders on behalf of an affiliated investment company that is registered with the SEC under the Investment Company Act of 1940. This exemption recognizes that such traders are generally in the same position as “buy-side” professionals

employed within investment companies, who would not be subject to the examination requirement.

Prerequisite Examination

As noted above, an individual must pass two examinations in order to be qualified as an Equity Trader. In addition to the required trader's examination (Series 55), Equity Traders must pass (or have passed) either the General Securities Registered Representative Examination (Series 7) or the Corporate Securities Limited Representative Examination (Series 62). This requirement is consistent with the requirements applicable to other specialized registration categories.

Grandfathering

The new qualification requirement for Equity Traders does NOT have a "grandfather" provision. The NASD believes that such a provision is not appropriate due to the necessity of ensuring even knowledge of existing rules among traders, as well as the large number of rule and structural changes occurring in the equity markets.

Grace Period

Individuals are allowed two years to pass the new Series 55 Exam if they are currently functioning as Nasdaq or OTC Equity Traders. The two-year grace period is intended to provide registered persons who presently are functioning as Equity Traders sufficient time to study and pass the examination without causing undue disruption in securities markets and in carrying out their responsibilities with their employer.

In order to avail itself of this grace period, the member firm must submit for the trader a registration application (or amendments thereto) with the NASD before **May 1, 1998**—30

days from the effective date of the rule. These traders then have until May 1, 2000, to pass the necessary examination(s). Should a trader fail to pass the exam within the two-year grace period, his or her registration as an Equity Trader will terminate on May 1, 2000.

Those individuals who apply for registration as Equity Traders after May 1, 1998, are subject to the NASD's normal qualification procedure. That is, such candidates must have passed either the Series 7 Exam or the Series 62 Exam, as well as the new Series 55 Exam, before functioning as Equity Traders.

Retaking Failed Exams

Member firms should be aware that the normal policy regarding waiting periods for candidates retaking a failed exam has been modified for candidates subject to the two-year grace period described above. Candidates in this category must wait 30 days before retaking a failed Series 55 Exam. Should the candidate fail the Series 55 Exam more than three times, the waiting period continues to be 30 days, rather than the 180-day waiting period normally required after the third and all subsequent failures. Please note that this exemption applies only to the Series 55 Exam, and it is only for those candidates who are allowed the two-year grace period. The normal waiting periods apply in all other circumstances, including those instances where an Equity Trader must pass either the Series 7 or Series 62 exams within the two-year grace period.

Registration Procedures

An application must be submitted to the NASD in order to register an individual as an Equity Trader. For persons already registered in one of the prerequisite categories, the member need only submit page one of Form

U-4 requesting Equity Trader (ET) registration. For new employees, a member must submit a full Form U-4 application requesting all necessary registrations and any other documents required for registration. The Series 55 Exam fee is \$60 and the registration fee for new applicants is \$85. The member firm should be aware of several details in submitting this form:

- In order to obtain the two-year grace period for the trader, the member firm must request the ET position before May 1, 1998.
- There may be instances when an applicant who is being registered as an Equity Trader before May 1, 1998, has not met the prerequisite. In this situation, a member also must request either the General Securities Representative (GS) or Corporate Securities Representative (CS) registration. Otherwise, the system will default to the CS position and show a deficiency. Such applicants must satisfy the prerequisite as soon as possible, but no later than the usual 90-day period from the time a prerequisite exam is scheduled.
- It is possible that a candidate who is within the two-year grace period may transfer to another member firm. If so, the grace period will continue to be available to the candidate. In other words, the candidate will continue to be allowed until May 1, 2000, to pass the examination.
- There will be instances when Equity Traders have become qualified as Limited General Securities Representatives by means of the various modules of the Series 7 Exam for foreign candidates.² These examinations meet the prerequisite for the Series 55 Exam. However, the member firm must contact the NASD Testing and Continuing

Education Department at (301) 590-6970 to make special arrangements for such persons.

The New Series 55 Examination

A study outline has been prepared to assist member firms in preparing candidates for the new Limited Representative–Equity Trader Examination (Series 55). It may be used to structure or prepare training material, develop lecture notes and seminar programs, and as a training aide to the candidates themselves.

The Series 55 Examination comprises 90 questions, and 180 minutes of testing time is allowed to complete the examination. A candidate must correctly answer 70 percent of the questions to receive a passing grade. The test is administered as a closed book exam. Scratch paper and a basic electronic calculator will be provided by the proctor. At the completion of the test, candidates will be provided with an informational breakdown of their performance on each of the sections, along with their overall score and grade.

The outline and the test are divided into four topical sections, which are described below along with the number of questions from each section:

Section 1—The Nasdaq Market and Market Maker Activities (47 questions)

Section 2—Automated Execution and Trading Systems (10 questions)

Section 3—Trade Reporting Requirements (13 questions)

Section 4—Securities Industry Regulations (20 questions)

The questions used in the examination will be updated to reflect the most current interpretations of the rules and regulations on which they

are based. Questions on new rules will be added to the examination within a reasonable period of the rules' effective dates. Questions on rescinded rules will be promptly deleted from the examination. Candidates will only be asked questions pertaining to rules that are effective at the time they take their exams.

Copies of the study outline and registration applications may be obtained from NASD MediaSourceSM, at (301) 590-6142, or from any of the NASD Regulation District Offices. There is a \$5 fee for the study outline.

Contact Persons

The following persons in NASD Regulation's Testing and Continuing Education Department may be contacted for additional information concerning the new qualification requirements and the Series 55 Examination:

Carole B. Hartzog, Lead Qualifications Analyst, at (301) 590-6696

Elaine P. Warren, Senior Qualifications Analyst, at (301) 590-6135

Eva E. Cichy, Qualifications Analyst, at (301) 208-2789

Text Of Rule Changes

(Note: New text is underlined.)

Rule 1032. Categories of Representative Registration

(f) Limited Representative–Equity Trader

(1) Each person associated with a member who is included within the definition of a representative as defined in Rule 1031 must register with the Association as a Limited Representative–Equity Trader if, with respect to transactions in equity, preferred or convertible debt securities

effected otherwise than on a securities exchange, such person is engaged in proprietary trading, the execution of transactions on an agency basis, or the direct supervision of such activities, other than any person associated with a member whose trading activities are conducted principally on behalf of an investment company that is registered with the Securities and Exchange Commission pursuant to the Investment Company Act of 1940 and that controls, is controlled by or is under common control, with the member.

(2) Before registration as a Limited Representative–Equity Trader as defined in subparagraph (1) hereof may become effective, an applicant must:

(A) be registered pursuant to Rule 1032, either as a General Securities Representative or a Limited Representative–Corporate Securities; and

(B) pass an appropriate Qualification Examination for Limited Representative–Equity Trader. Any person who has filed an application to take this examination by May 1, 1998, must pass the examination by May 1, 2000. Any person who is eligible for this extended qualification period and who fails this examination during such twenty-four (24) month time period must wait (30) days from the date of failure to take the examination again. Any person who files an application to take this qualification examination after May 1, 1998, must pass this examination before conducting such activities as described in paragraph (f)(1) above. In no event may a person who is eligible for the extended qualification period function as an Equity Trader beyond the 24-month period without having successfully passed the appropriate qualification examination.

Endnotes

¹ In this context, references to the Series 7 Examination include the various submodules of the Series 7 Exam for foreign candidates.

² These currently are the Series 17 exam (IE) for candidates from the U.K. and the two Canadian modules—the Series 37 Exam (CD) and the Series 38 Exam (CN).

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