

INFORMATIONAL

**Series 55—
Equity Trader
Examination**

**NASD Announces
Interpretation Of NASD
Rule 1032(f) Regarding
Series 55/Equity Trader
Registration Requirement****SUGGESTED ROUTING**

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Executive Representatives
- Legal & Compliance
- Registration
- Senior Management
- Trading & Market Making
- Training

KEY TOPICS

- Equity Trader
- Proprietary Trading
- Series 55 Examination

Executive Summary

NASD Regulation, Inc. (NASD RegulationSM) has received a number of inquiries regarding the registration category for representatives who trade equity securities in The Nasdaq Stock Market[®] (Nasdaq[®]) and/or over-the-counter (Series 55). The purpose of this *Notice to Members* is to revise NASD Regulation's position regarding the scope of the Series 55 registration requirement. Previously, NASD Regulation took the position that any associated person who makes trading decisions that place a firm's capital at risk needs to be registered under Series 55. In this *Notice to Members*, NASD Regulation is announcing that such decision-makers only need the Series 55 registration if they also are involved in the execution or processing of trades.

Questions/Further Information

Questions regarding this *Notice* may be directed to Carole Hartzog, Assistant Director, Member Regulation, Testing and Continuing Education, NASD Regulation, at (301) 590-6696; or Eric Moss, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8982.

Background

Effective April 1, 1998, NASD Regulation amended its rules to require representatives who trade equity securities in Nasdaq or over-the-counter markets to register as equity traders. NASD Rule 1032(f) established the Series 55 registration category and qualification examination for equity traders.

Specifically, NASD Rule 1032(f) states that a representative must

register as a "Limited Representative—Equity Trader" if the representative is engaged in proprietary trading or in the execution of transactions on an agency basis in equity, preferred, or convertible debt securities. The Rule also applies to persons who directly supervise those who are engaged in such activities. In order to register as a Limited Representative—Equity Trader, representatives must be registered as General Securities Representatives (Series 7) or as Limited Representatives—Corporate Securities (Series 62) and must pass the Series 55 Examination. Rule 1032(f) contains an exemption for representatives whose principal trading activities involve executing orders on behalf of affiliated investment companies registered with the SEC under the Investment Company Act of 1940.

NASD Regulation has received a number of inquiries from member firms and registered representatives regarding the registration requirements for equity traders. In the Fall 1999 issue of *Regulatory & Compliance Alert*, NASD Regulation addressed many of these issues.¹ Since the date of this publication, NASD Regulation has received additional inquiries as to the scope of the equity trader registration requirement, particularly whether certain decision-makers who direct investments of firms' proprietary capital need to register under Series 55. These requests have caused NASD Regulation to reconsider its prior position. As noted above, previously, NASD Regulation took the position that any associated person who makes trading decisions that place a firm's capital at risk needs to be registered under Series 55. In this *Notice to Members*, NASD Regulation is revising this position.

Interpretive Guidance

In this *Notice to Members*, NASD Regulation is announcing that a person will not be deemed to be engaged in proprietary trading for purposes of the equity trader registration requirement based solely on the fact that he or she is making decisions to invest the firm's capital in specific Nasdaq or over-the-counter securities. This conclusion, however, assumes that this person will not participate in the execution or processing of trades, and that someone qualified under Series 55 will perform these tasks. The following questions and answers illustrate this position.

Q. 1. A fully disclosed broker/dealer is investing its capital in Nasdaq and/or over-the-counter equity securities. The president of the broker/dealer occasionally selects a particular investment, including quantity and price (if limit order). The trades are submitted to a clearing firm for execution; the president plays no role in the execution or processing of the trade. Would the president be subject to the Series 55 registration requirement?

A. No. The president is not involved in the execution or processing of trades. If anyone at the firm is involved in the execution or processing of the trades, that person would need to be registered under Series 55.

Q. 2. A fully disclosed broker/dealer is investing its capital in Nasdaq and/or over-the-counter equity securities. The president of the broker/dealer occasionally selects a particular investment, including quantity and price (if limit order). The trades are submitted to a clearing firm for

execution; however, the president is involved in negotiating the terms of the transaction with the contra-side of the transaction. Would the president be subject to the Series 55 registration requirement?

A. Yes. The president is engaged in proprietary trading, and needs to be registered under Series 55. The president is establishing the terms of the trade with the contra-side of the transaction.

Q. 3. A fully disclosed broker/dealer is investing its capital in Nasdaq and/or over-the-counter equity securities. The president of the broker/dealer is the immediate supervisor of a trader who negotiates the terms of the transactions in Nasdaq and/or over-the-counter equity securities. The trades are submitted to a clearing firm for execution; the president plays no role in the execution or processing of the trades. Would the president be subject to the Series 55 registration requirement?

A. Yes. The president would need to register under Series 55. Rule 1032(f) applies to persons who directly supervise equity traders.

Q. 4. A broker/dealer is registered with the SEC as an investment adviser. Investment management professionals at the firm produce portfolio management advice that is used by the firm's investment advisory clients, and by the firm in its own proprietary trading. Whenever an investment management professional determines that a security should be purchased or sold for the firm's proprietary account,

he or she communicates with a trader employed by the firm. The investment management professional does not communicate any information to the traders other than to occasionally identify particular investments, including quantity and price (if limit order). The traders are required to be Series 55 registered. Would the investment management professionals be subject to the equity trader registration requirement?

A. No. The investment management professionals are not involved in the execution or processing of trades.

Q. 5. A person processes proprietary trades for a firm by calling or electronically communicating with a contra-side to the transaction. Is this person engaged in proprietary trading, and therefore required to register as a Series 55 representative?

A. Yes. NASD Rule 1032(f) covers proprietary traders who effect any transaction in equity, preferred, or convertible debt securities in the Nasdaq or over-the-counter markets.

Q. 6. Under a payment-for-order-flow relationship, Firm A routes all its proprietary and agency orders to Firm B for execution. Is Firm A involved in the execution or processing of trades?

A. No. Firm A is not involved in the execution or processing of trades, and its personnel will not be required to be registered under Series 55. The result would be the same if Firm A routes orders to multiple firms

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for execution. Further, the payment-for-order-flow arrangement is not a fact that is taken into consideration in this situation.

Endnote

¹To the extent that this *Notice to Members* conflicts with prior positions taken by NASD Regulation staff, including guidance outlined in the NASD's *Regulatory & Compliance Alert* (Fall 1999), the guidance provided in this *Notice to Members* is controlling.

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