

# NASD NOTICE TO MEMBERS 98-16

## SEC Approves New Qualification Examination For Government Securities Representatives (Series 72) And New Registration Requirements For Registered Options Representatives (Series 42)

### Suggested Routing

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### Executive Summary

On August 25, 1997, the Securities and Exchange Commission (SEC) approved amendments to the National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) Rules regulating qualifications of government securities representatives. As of April 1, 1998, the effective date of the rule, registered representatives will be required to pass a qualification examination in order to sell or otherwise engage in government securities activities. A new NASD qualification examination, the Government Securities Limited Representative Examination (Series 72), will be available on April 1, 1998, and will provide an alternative to the General Securities Registered Representative Examination (Series 7) for qualification of individuals who function solely as government securities representatives.<sup>1</sup> The rule change approved by the SEC also conforms to the registration requirements of the existing Registered Options Representative (Series 42) category to take into consideration the new qualification requirements.

### Background

Prior to 1986, government securities were "exempt" from various provisions of the Securities Exchange Act of 1934 (1934 Act). As a consequence, a broker/dealer engaged solely in a government securities business was not required to be registered with the SEC and its associated persons were not subject to any qualification standards. The Government Securities Act of 1986 (1986 Act) amended these provisions of the 1934 Act. Among other things, the 1986 Act required sole government securities broker/dealers to register with the SEC for the first time. It also granted the NASD authority to require the associated persons of these firms to register with the NASD, but it did not authorize the NASD to establish qualification examination standards. As a result,

since January of 1989, the NASD has required these associated persons to register as government securities representatives or government securities principals, but has not required them to pass a qualification examination. Under a 1993 amendment to the 1934 Act, the NASD was authorized for the first time to apply its qualification examination standards to government securities representatives and government securities principals. The first of these examinations, the Government Securities Limited Representative Examination (Test Series 72), has been approved by the SEC.

### Qualification Requirements

As of April 1, 1998, a registered representative must pass a qualification examination in order to sell or trade government securities. This may be either the Series 7 Examination or the new Series 72 Examination. The fee for new applicant registration is \$85; for the Series 7 Examination, \$150; and for the Series 72 Examination, \$60. The Government Securities Limited Representative Qualification Examination (Series 72) has been developed to qualify persons seeking registration with the NASD under By-Laws Article II, Section 2 and new Rule 1032(g) thereunder.<sup>2</sup> Registered representatives in this limited category of registration are permitted to transact a member's business in Treasury securities, Agency securities, and Agency mortgage-backed securities. This category, by itself, does not allow registered representatives to transact a member's business in options on government securities. Candidates seeking to do transactions in this latter product also must meet additional qualification and registration standards as described below.

## Grandfathering

NASD Regulation, Inc. (NASD Regulation<sup>SM</sup>) adopted a “grandfather” provision for certain government securities representatives. Persons who were registered with the NASD as government securities representatives and/or government securities principals on or before April 1, 1996 (two years prior to the effective date of the rule) will be grandfathered and may register as government securities representatives without having to take an examination. This grandfather provision assumes that the representative is not currently subject to a statutory disqualification as defined in Section 3(a)(39) of the 1934 Act or has not been subject to a suspension or fine of \$5,000 or more imposed by a securities or commodities regulator in the 10 years before the effective date of the rule.

This grandfather provision is not available for individuals who registered as government securities representatives or government securities principals from April 1, 1996, to March 31, 1998. However, such individuals may continue to function as government securities representatives for up to six months from the effective date of the rule, that is, until September 30, 1998. During this time, these representatives must take and pass either the Series 72 Exam or the Series 7 Exam. Should the individual fail to pass the exam within the grace period, his or her registration as a government securities representative will terminate on October 1, 1998. The member firm should be aware that the normal periods a candidate must wait before retaking a failed exam apply. Consequently, should a candidate in this category fail the exam three times, the candidate’s registration will terminate on October 1, 1998.

Those individuals who register as government securities representatives on or after April 1, 1998, are subject to the NASD’s normal qualification procedure. That is, the candidate must take and pass either the Series 7 Exam or the new Series 72 Exam before functioning as a government securities representative.

## Government Securities Principals

The registration requirements for government securities principals remain unchanged. NASD Rule 1111 requires all persons associated with a member who function as government securities principals to register as such, but does not require them to pass a principal-level qualification examination. This requirement to register without passing an exam applies only if the individual is not registered as a principal in any other capacity. To the extent such principals also function as representatives, they would be subject to the qualification/registration requirements for government securities representatives discussed above.

## Qualification To Sell Options On Government Securities

Currently, individuals who sell options on government securities are not required to pass a qualification examination. Rule 1032(d) for registered options representatives has been amended to establish registration and qualification requirements for such individuals, and to add the Series 72 Examination to the list of those examinations that pre-qualify an individual to take the Limited Representative—Options (Series 42) Examination. As of April 1, 1998, a person selling options on government securities will be required to pass the new Series 72 Examination and the existing Series 42 Examination. Such a person’s qualification is limited to the sale of options on gov-

ernment securities. Alternatively, a person could qualify for the sale of government securities and options on government securities by passing the Series 7 Examination.

## Alternative Qualification As A General Securities Representative<sup>3</sup>

As of the April 1, 1998 effective date of the rule, the new Series 72 Examination will be added to the “family” of limited exams that convey NASD General Securities Representative status when completed as a group. Passing this family of six modular exams in lieu of the Series 7 Exam offers members more flexibility in satisfying NASD registration requirements. The five NASD<sup>4</sup> and one Municipal Securities Rulemaking Board (MSRB) examinations are:

- Investment Companies and Variable Contracts Representative Examination (Series 6)
- Direct Participation Programs Limited Representative Examination (Series 22)
- Registered Options Limited Representative Examination (Series 42)
- MSRB Municipal Securities Representative Examination (Series 52)
- Corporate Securities Limited Representative Examination (Series 62)
- Government Securities Limited Representative Examination (Series 72)

## Registration Procedures

There are various registration scenarios that could apply to representatives engaged in government securities activities and/or solicitation

or sale of options on government securities. These are presented below in a question and answer format. Although the term "selling" will be used for simplicity, these discussions refer to any activity in government securities or options on government securities. This includes selling to retail or institutional customers, trading, or any applicable form of investment banking.

**Question:** What is the status of an individual who is registered as a general securities representative (Test Series 7) or who takes the Series 7 Exam after April 1, 1998?

**Answer:** Such a person is qualified to sell both government securities and/or options on government securities, without meeting any further qualification requirements.

**Question:** An individual has been registered as a representative in another category, *e.g.*, Series 6 or Series 62. This representative also sells government securities, but never registered as a government securities representative because it was not required.<sup>5</sup> May this representative continue to sell government securities without taking an exam?

**Answer:** No. An individual in this category must pass either the Series 72 Exam or the Series 7 Exam in order to continue selling government securities.

**Question:** There are individuals in our firm who were registered as government securities representatives on or before April 1, 1996. Must they take the new Exam?

**Answer:** No. Such individuals are grandfathered as government securities representatives and are not subject to the examination requirement.

**Question:** If individuals are grandfathered as government securities representatives, and they also sell options on government securities, are they also grandfathered as registered options representatives?

**Answer:** No. This person must pass the Registered Options Representative (Series 42) Exam in order to continue selling options on government securities on and after April 1, 1998. However, this person has met the prequalification requirement for the Series 42 Exam by virtue of being grandfathered as a government securities representative.

**Question:** Various individuals in our firm were registered as government securities representatives after April 1, 1996, but before April 1, 1998. May they continue to sell government securities without first passing the qualification exam?

**Answer:** Yes. Such persons have a six-month grace period to take the Exam. If they have not passed the Exam by the end of this grace period, that is, by September 30, 1998, then they must cease functioning as government securities representatives until they have passed the Exam.

**Question:** What is the status of an application to be a government securities representative that is received on or after April 1, 1998?

**Answer:** These applications will be handled in the normal manner, that is, the applicant must take and pass either the Series 72 or the Series 7 Exam before functioning as a government securities representative.

**Question:** Our firm accidentally submitted a revised Form U-4 requesting the Series 72 Exam for a candidate who already has the "GS" (General Securities Representative—Series 7) status. What effect will this have?

**Answer:** When you request an examination, CRD will schedule the exam irrespective of the candidate's qualification status. It then becomes the firm's responsibility to correct this situation by contacting CRD/Public Disclosure Gateway, at 301-590-6500.

## The New Series 72 Examination

The new Series 72 Exam is comprised of 100 questions, and 180 minutes of testing time is allowed to complete the test. 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 basic electronic calculators will be provided by the proctor. At the completion of the test, each candidate will be provided with an informational breakdown of his or her performance in each of the major sections, along with his or her overall score and the grade derived therefrom.

Topics in this examination may be tested by requiring a candidate to apply the concepts to real life situations. In some instances, this may require basic level computations. 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 time period after the rules' effective dates. Questions on rescinded rules will be deleted promptly from the examination.

A study outline has been prepared to assist member firms in preparing candidates for the Series 72 Examination. It may be used to structure or prepare training material, develop lecture notes and seminar programs, and as a training aide for the candidates themselves. The outline and the test are divided into six topical

sections, which are listed below along with the number of questions in each section:

Section 1—Government Securities (25 questions)

Section 2—Mortgaged-Backed Securities (25 questions)

Section 3—Other Related Securities and Financial Instruments (9 questions)

Section 4—Economic Activity, Government Policy, and the Behavior of Interest Rates (16 questions)

Section 5—Legal Considerations (10 questions)

Section 6—Customer Considerations (15 questions)

Copies of the study outline and registration applications may be obtained from NASD MediaSource, 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 Qualifications and Exams Department may be contacted for additional information concerning the new qualification requirements and the Series 72 Examination:

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

Frank J. McAuliffe, Vice President, at (301) 590-6694

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

## Text Of Rule Changes

(Note: New text is underlined; deletions are bracketed.)

### Rule 1032. Categories of Representative Registration

#### [(d) Registered Options Representative]

[Each person associated with a member whose activities in the investment banking or securities business include the solicitation and/or sale of option contracts shall be required to be certified as a Registered Options Representative and to pass an appropriate certification examination for such or an equivalent examination acceptable to the Association. Registered Options Representatives qualified in either put or call options shall not engage in both put and call option transactions until such time as they are qualified in both such options. Members shall be required to report to the Association the names of any associated persons certified as Registered Options Representatives pursuant to an examination approved by the Association. Registered Options Representatives must also be qualified with the Association as either General Securities Representatives or as Limited Representatives—Corporate Securities; provided, however, Registered Options Representatives of members that are members of a national securities exchange which has standards of approval acceptable to the Association may be deemed to be approved by and certified with the Association, so long as such representatives are approved by and registered with such exchange.]

#### **(d) Limited Representative—Options**

(1) Each person associated with a member who is included within the definition of a representative as defined in Rule 1031 may register

with the Association as a Limited Representative—Options if:

(A) such person's activities in the investment banking or securities business of the member involve the solicitation or sale of option contracts, including option contracts on government securities as that term is defined in Section 3(a)(42)(D) of the Act, for the account of a broker, dealer or public customer; and

(B) such person passes an appropriate qualification examination for Limited Representative—Options.

(2) Each person seeking to register and qualify as a Limited Representative—Options must, concurrent with or before such registration may become effective, become registered pursuant to the Rule 1032 Series, either as a Limited Representative—Corporate Securities or Limited Representative—Government Securities.

(3) A person registered as a Limited Representative—Options shall not be qualified to function in any area not prescribed by subparagraph (1)(A) hereof.

#### **(g) Limited Representative—Government Securities**

(1) Each person associated with a member who is included within the definition of a representative as defined in Rule 1031 may register with the Association as a Limited Representative—Government Securities if:

(A) such person's activities in the investment banking or securities business involve the solicitation, purchase or sale of "government securities," as that term is defined in Section 3(a)(42)(A) through (C) of the Act, for the account of a broker, dealer or public customer, and

(B) such person passes an appropriate qualification examination for Limited Representative—Government Securities.

(2) A person registered solely as a Limited Representative—Government Securities shall not be qualified to function in any area not prescribed by subparagraph (1)(A) hereof.

(3) A person who has been performing the functions of a Limited Representative—Government Securities on or before April 1, 1996, may register as such without first meeting the requirement of subparagraph (1)(B) above unless (A) such person is currently subject to a statutory disqualification as defined in Section 3(a)(39) of the Act or (B) during the past ten years before the effective date of that requirement was the subject of a suspension or fine of \$5,000 or more by the Association, the Securities and Exchange Commission, the Commodity Futures Trading Commission, state securities commission, foreign financial regulatory authority, or any other regulatory organization responsible for the investment banking or securities business.

#### **[1112. Registration of Representatives]**

[All persons associated with a member who are to function as government securities representatives who

have not previously been registered shall be registered as such with the Association.

#### **(a) Definition of Representative**

Persons associated with a member, including assistant officers other than principals, who are engaged in the government securities business for the member including:

- (1) underwriting, trading or sales of government securities;
- (2) financial advisory or consultant services for issuers in connection with the issuance of government securities;
- (3) research or investment advice, other than general economic information or advice, with respect to government securities in connection with the activities described in subparagraphs (1) and (2) above;
- (4) activities other than those specifically mentioned that involve communication, directly or indirectly, with public investors in government securities in connection with the activities described in subparagraphs (1) and (2) above;

are designated as representatives.

#### **(b) Notification of Representative Status**

A member shall promptly notify the Association of the assumption by an individual not previously registered with the member of representative status on the form designated by the Board of Governors accompanied by the applicable fees.]

#### **Endnotes**

<sup>1</sup> This alternative means to qualification may not be available to joint NASD/NYSE member firms.

<sup>2</sup> New Rule 1032 (g) replaces Rule 1112, which has been deleted.

<sup>3</sup> This alternative route to general securities qualification is not available to joint NASD/NYSE member firms.

<sup>4</sup> The new Equity Traders Examination (Series 55) is not part of this group.

<sup>5</sup> Former NASD Rule 1112 required all persons associated with a member who functioned as government securities representatives to register as such without first passing a qualification examination. But this requirement applied only if the individual was not registered as a representative in any other capacity.

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