

change pursuant to Rule 19b-4(f)(6) under the Act.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

### **I. Self-Regulatory Organization's Statement of the Terms of Substance of Proposed Rule Change**

In this filing, the NASD discusses the implementation of new and revised qualification examinations to address trading in security futures.

The NASD does not propose to amend any of its existing rule text.

### **II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in item IV below. The NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

#### **A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

##### **1. Purpose**

The commodity Futures Modernization Act of 2000 ("CFMA")<sup>4</sup> lifted the ban on the trading of security futures (*i.e.* futures on single stocks and on narrow-based stock indexes). The NASD states that, at the time the CFMA was enacted, expectations for security futures were very high, and two separate markets were developed to trade these new products. To meet the challenge of ensuring that individuals engaging in a security futures business are properly qualified, the NASD took the unique step of mandating that firms include training in security futures as part of their firm-element continuing education program. Furthermore, to assist firms in meeting this responsibility, the NASD and the National Futures Association ("NFA") contracted with the Institute for Financial Markets to develop an internet-based training program. NASD and NFA have made this program available to firms and registered representative for free. Since its inception in October 2002, over 12,000 individuals have completed the Internet

training, which takes approximately two to three hours to complete.

At the time trading in security futures commenced, NASD also indicated that it planned to both modify and create qualification examinations to address trading in security futures. Specifically, NASD intended to modify the Series 4 examination (Registered Options and Security Futures Principal (replacing Registered Options Principal)), Series 9/10 examination (Limited Principal General Securities Sales Supervisor), and Series 42 examination (Limited Representative Options and Security Futures (replacing Limited Representative Options)). In addition, NASD intended to create a new Series 43 examination for general securities representatives (those persons who have successfully completed the Series 7 exam) seeking to engage in a security futures business.<sup>5</sup> The Series 43 is targeted at new entrants into the securities industry. Existing registrants (*i.e.*, those registered before the Series 43 examination is effective) are required to complete a firm-element continuing education program prior to engaging in a security futures business. Once the Series 43 was developed, NASD intended to permit existing registrants the option of completing the firm-element continuing education program in lieu of the Series 43 examination until December 31, 2006.

In the approximately one year since security futures began trading, NASD has devoted substantial resources to creating the Series 43 examination. Industry and SRO representatives<sup>6</sup> have met for 11 days and have devoted collectively over 1800 hours in meeting time developing a content outline and a question bank for the Series 43.<sup>7</sup> In addition, NASD has incurred over \$45,000 in expenses to develop these materials. The Series 43 examination development is now complete. Revised study outlines for the Series, 4, 9/10 and 42 also have been developed. Questions for those examinations will be borrowed from the Series 43 question bank and developed by committees charged with maintaining and reviewing the question banks for those examinations.

Despite these efforts, current data on trading volume has shown that there is very limited trading activity in security

futures. According to data from the Options Clearing Corporation, the average trading volume for 2003 in security futures is around 10,000 contracts per day across the two exchanges. In addition, NASD's market regulation surveillance confirms that most of this volume is proprietary trading among market-maker firms. NFA representatives have informed the NASD that security futures products represented 0.0028% of all futures contracts traded so far in 2003. While similar statistics are not calculated for the securities industry, the figures would be substantially lower given the size of the securities markets.

Moreover, interest among registered representatives to engage in a security futures business has waned. Since July 2003, an average of fewer than 50 registered persons per month in the securities industry have completed the Internet-based continuing education.

In view of the foregoing, the NASD does not believe it is appropriate or necessary to institute the Series 43 exam or amend other existing qualification examinations at the present time. The NASD believes the current system of a firm-element continuing education requirement continues to work well. The NASD states that the feedback it has received on the Internet-training program has been very positive. In addition, the NASD states that it has not received any evidence of customer complaints in these products. Moreover, the NASD is hesitant to amend existing examinations to address security futures because the net result will be to deemphasize other more pertinent subject areas, as the NASD does not intend to expand the number of questions on the Series 4, 9/10, and 42 exams.<sup>8</sup> Finally, the introduction of a separate, stand-alone qualification examination for security futures seems excessive in view of the level of trading in these products. The NASD also anticipates that very few representatives would elect to take the Series 43 exam.

The NASD notes that its colleagues at NFA have made similar conclusions about the need to revise the Series 3 to reflect trading of security futures. Both NASD and NFA believe that the qualification requirements between the securities and futures industry should generally be comparable, and, as regulators, the NASD has sought to avoid favoring one industry group over another, or actions leading to regulatory arbitrage.

<sup>5</sup> A new Series 43 examination was necessary, in part, because the New York Stock Exchange did not intend to incorporate questions on security futures on the Series 7 examination.

<sup>6</sup> SRO representatives from the NASD, NFA, CBOE, AMEX, OneChicago, and NQLX helped develop the content outline and question bank.

<sup>7</sup> These totals do not include travel time, time spent preparing for meetings (including developing and reworking questions), and NASD staff time administering the Series 43 program.

<sup>8</sup> The problem is equally acute on the futures industry side, where the proposed revised Series 3 examination will have approximately 17% of its questions addressing security futures.

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> P.L. 106-554, 114 Stat. 2763 (December 21, 2000).