

November 21, 1986

Ms. Jean A. Webb
Secretary
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, DC 20581

Re: National Futures Association, Proposed Amendment to
Section II of Schedule A to Bylaw 305.

Dear Ms. Webb:

Pursuant to Section 17(j) of the Commodity Exchange Act ("Act"), as amended, National Futures Association ("NFA") hereby submits to the Commodity Futures Trading Commission ("Commission") a proposed amendment to Section II of Schedule A to Bylaw 305. The amendment was adopted by NFA's Board of Directors at its meeting on November 20, 1986.

I. THE PROPOSED AMENDMENT

- A. Amendment to Bylaw 305, Schedule A, Section II to revise NFA's proficiency testing requirements (additions are underscored and deletions are [bracketed]):

**BYLAWS OF
NATIONAL FUTURES ASSOCIATION**

* * *

**CHAPTER 3
MEMBERSHIP AND ASSOCIATION WITH A MEMBER**

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Bylaw 305. Registration and Proficiency Requirements.

* * *

Schedule A

* * *

II. Proficiency Requirements

[(a) Associated Person Qualification Testing
Requirement]



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[Except as provided below in paragraph (b),] Any individual applying to NFA for registration under the Act as a futures commission merchant, an introducing broker, a commodity pool operator, a commodity trading advisor or as an associated person of any of the foregoing or applying for registration with NFA as an Associate pursuant to NFA Bylaw 301(b) shall not be registered, temporarily licensed or registered with NFA as an Associate unless:

- (1) NFA receives satisfactory evidence that the applicant has taken and passed the National Commodity Futures Examination on a date which is no more than two years prior to the date the application is received by NFA, or
- (2) The applicant has been duly registered under the Act as a futures commission merchant, an introducing broker, a commodity pool operator, a commodity trading advisor or as an associated person of any of the foregoing at any time during the two-year period immediately preceding the date the application is received by NFA, or
- (3) NFA receives a certification, which shall be considered incorporated into the application for registration under the Act, signed by both the applicant and the applicant's sponsor, stating that:
 - (i) the applicant is currently registered with the National Association of Securities Dealers, Inc. as a General Securities Representative, and
 - (ii) the applicant's sole activities, subject to regulation by the Commission, are and will continue to be limited to:
 - (a) the solicitation of funds, securities or property for participation in a commodity pool, or
 - (b) referring clients to an associated person who has satisfied the proficiency requirements set forth in this Section II of Schedule A to Bylaw 305, provided that the applicant's referral of clients is solely incidental to his business as a General Securities Representative, or
 - (c) the supervision of persons whose activities are limited as set forth above ==



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unless and until the applicant submits to NFA satisfactory evidence of having taken and passed the National Commodity Futures Examination, and

- (iii) the applicant's sponsor understands that the sponsor must supervise the applicant's compliance with the limitation on the applicant's activities set forth in paragraph (ii) above and that any failure of the applicant to adhere to those limitations may be cause for, among other things, disciplinary action by NFA against the sponsor for violation of NFA Compliance Rule 2-9, and
- (iv) the applicant and the applicant's sponsor understand that willfully making a materially false or misleading statement in any part of the application for registration, including the certification described above, is cause for denial, suspension or revocation of registration and criminal prosecution.

[(b) The requirements set forth above in paragraph (a) shall not apply to individuals who were registered as an associated person or who had applied for such registration as of the applicable date listed below and whose registration as such is not lapsed when application to NFA is made:

- (1) August 1, 1983 for individuals applying for registration as an introducing broker or as an associated person of an introducing broker;
- (2) March 1, 1984 for individuals applying for registration as a futures commission merchant, commodity pool operator or commodity trading advisor or as an associated person of a futures commission merchant, commodity pool operator or commodity trading advisor.

(c) Any individual who is subject to the requirement of paragraph (a) and who becomes registered under the Act as an associated person of a futures commission merchant, an introducing broker, a commodity pool operator or a commodity trading advisor by filing a form 8-S pursuant to the special registration provision of CFTC Rules 3.12(d) or 3.16(d) must provide NFA with satisfactory evidence that the applicant has satisfied one of the requirements set forth above in paragraph (a) within 60 days of the mailing of the form 8-S. Failure to do so shall cause such individual's registration to lapse.]



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II. EXPLANATION OF THE PROPOSED AMENDMENT

Section II of NFA Bylaw 305 Schedule A sets forth the requirements and procedures relating to proficiency testing of Members and Associates ("Testing Requirements"). Specifically, each individual applying to NFA for registration as an FCM, IB, CPO, CTA or as an AP will not be registered or temporarily licensed unless:

1. NFA receives evidence that the applicant has passed the National Commodity Futures Examination, or
2. NFA receives a certification signed by the applicant and the sponsor stating that:
 - (1) the applicant is currently registered with the NASD as a General Securities Representative and
 - (2) the applicant's sole activities subject to CFTC regulation are limited to
 - (a) the solicitation of funds, securities or property for participation in a commodity pool, or
 - (b) referring clients to a fully tested AP, provided that the referral of clients is solely incidental to the applicant's business as a General Securities Representative, or
 - (c) the supervision of persons whose activities are limited as set forth above.

The above requirements do not apply if the applicant is "grandfathered" - that is, is and has been continuously registered since before the applicable date.

In addition, NFA Compliance Rule 2-24 prohibits NFA members from employing any person as an Associate unless that person has satisfied the requirements of Bylaw 305, Schedule A, Section II.

In the vast majority of cases NFA Testing Requirements operate in the way they were designed. That is, new APs coming into the industry must pass the NCFE before they can become registered. However, it has been NFA's experience in administering the Testing Requirements that from time to time situations arise that



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can produce unintended results. For example, an individual who passed the NCFE and became registered as an AP in 1975, but left the industry in 1976 and has remained out of the industry since, could under the current Testing Requirements be registered without having to take the test again if the individual can provide satisfactory evidence that he passed the test in 1975. This fact pattern raises several concerns. First, such individuals usually do not retain documentary evidence that they passed the NCFE, and they try to prevail upon their former employers or the Membership Services Department of the Chicago Board of Trade to search their files for such evidence. This represents a potential hardship to FCMS and the CBOT.

More importantly, however, the futures industry is dynamic and has changed significantly in recent years. Many new contracts, including options, are now being traded and the regulatory structure is certainly different. This raises serious questions as to whether passing the NCFE a number of years ago should be accepted as evidence of satisfactory entry level knowledge for persons who have been out of the futures industry for some time and seek to re-enter it.

Another type of complication arises when an AP who has been grandfathered loses such status due to a brief lapse in registration. There have been isolated cases in which individuals who have been continuously in the futures business for many years terminate their employment with their firms and become associated with a new sponsor 90 or 120 days later. Because these individuals did not transfer their registration within the 60-day period set forth in the Commission Regulations, their registrations lapse and they must be treated as new applicants, which means they must take and pass the NCFE even though they have only been out of the business for a few months.

NFA's Educational/Testing Advisory Committee ("Committee") considered these apparent incongruities in the Testing Requirements and recommended that certain amendments be adopted. NFA's Board concurred in the Committee's recommendations. First, the Committee recommended that any applicant who had previously been registered and had passed the NCFE but who has not been registered within the two years prior to application be required to retake and pass the test in order to become registered.

Second, the Committee recommended that any applicant who has been registered at some time within the previous two years not be required to take the test. This would apply to applicants who



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were previously grandfathered as well as to applicants who had passed the exam in conjunction with the prior registration. Because the latest of NFA's grandfathering dates is March 1, 1984, and because this amendment would not go into effect until March 1, 1987, anyone applying for registration at or after that time who had been previously grandfathered and who had not been out of the industry for more than two years would necessarily have at least a year's experience (March 1, 1984 to March 1, 1985). NFA believes that the experience which an AP gains under adequate sponsor supervision in a period of one year provides assurance that such an AP has attained the required level of knowledge which would otherwise be tested for by the exam.

The two-year limitation in the proposed amendment will serve to ensure that applicants have the necessary entry level knowledge to deal with customers, and at the same time will eliminate instances in which applicants who are clearly knowledgeable are nevertheless required to take the exam in order to be registered. NFA also considered that the rules of the National Association of Securities Dealers provide for a substantially identical two-year limitation period, and that CBOT rules included similar provisions when the exchange was responsible for administering the exam.

The adoption of this amendment involves two other changes to the Testing Requirements. First, the grandfathering dates (Section (b)) can be eliminated, because no applicant who is not currently registered can meet the grandfathering dates and any current registrant who becomes unregistered and later re-applies will now be subject to the two-year rule, not grandfathering.

Second, Section (c) can be eliminated completely, as its historical purpose has been served. When the Testing Requirements were adopted, the grandfathering date established for APs of IBs was August 1, 1983, while the grandfathering date for APs of FCMS was March 1, 1984. Section (c) was designed to prevent APs of IBs who became registered between August 1, 1983, and March 1, 1984, from avoiding the testing requirement by becoming registered as APs of FCMS and then transferring to an IB pursuant to the 8-S procedure. There is no reason to retain this Section now.



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Upon approval by the Commission, NFA intends that the amendment to Bylaw 305, Schedule A, Section II become effective on March 1, 1987. All applicants applying for registration as an FCM, IB, CPO or CTA, or as an AP of any of the foregoing, on or after that date would be subject to the revised Testing Requirements.

Very truly yours,

A handwritten signature in cursive script that reads "Karen M. Dorff".

Karen M. Dorff
Assistant General Counsel

cc: Chairman Susan M. Phillips
Commissioner Kalo A. Hineman
Commissioner Fowler C. West
Commissioner William E. Seale
Commissioner Robert R. Davis
Andrea M. Corcoran
Kenneth M. Raisler
Dennis Klejna
Kevin M. Foley
Kenneth M. Rosenzweig

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UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

2033 K Street, N.W.
Washington, D.C. 20581



February 17, 1987

Karen M. Dorff, Esq.
Assistant General Counsel
National Futures Association
200 West Madison Street
Chicago, Illinois 60606

Re: Amendments to Section II of Schedule A to National
Futures Association Bylaw 305

Dear Ms. Dorff:

By letter dated November 21, 1986, the National Futures Association submitted the above-referenced amendments to the Commission for its approval pursuant to Section 17(j) of the Commodity Exchange Act. The Commission understands that, upon Commission approval, NFA intends to make the amendments effective March 1, 1987. This is to inform you that the Commission has this date approved the NFA submission pursuant to Section 17(j) of the Act.

Very truly yours,

Jean A. Webb
Jean A. Webb
Secretary of the Commission

