[Release No. 34–37690; File No. SR–CHX–96–11]

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to Examinations

September 17, 1996.

I. Introduction

On March 6, 1996, the Chicago Stock Exchange, Inc. (''CHX'' or ''Exchange'') submitted to the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] a proposed rule change, on March 18, 1996, filed Amendment No. 1 to the proposed rule change,[3] and on April 4, 1996, filed Amendment No. 2 to the proposed rule change,[4] to amend Rules 2 and 3 of Article VI (and the interpretations and policies thereunder) to clarify existing rules, adopt a new Floor Membership Exam, adopt a new Market Maker Exam, adopt a new Co-Specialist Exam, and adopt examinations applicable to persons conducting a customer business from the CHX trading floor. The Exchange also proposed to adopt the Content Outline for the Examination Module for Floor Members Engaged in a Public Business with Professional Customers and the Content Outline for the Examination Module for Floor Clerks of Members engaged in a Public Business with Professional Customers (collectively, the ''Content Outlines'').[5] The proposed rule change, Amendment No. 1, and Amendment No. 2 were published for comment in Securities Exchange Act Release No. 37067 (April 4, 1996), 61 FR 16274 (April 12, 1996). One comment was received on the proposal.[6] On June 3, 1996, in response to Comment Letter No. 1, the Exchange submitted to the Commission Amendment No. 3 to the proposed rule change.[7] Amendment No. 3 clarifies the proposed amendments to Rule 2 of Article VI. Amendment No. 3 was published for comment in Securities Exchange Act Release No. 37324 (June 18, 1996), 61 FR 32872 (June 25, 1996). One comment was received on the proposal.[8] The CHX submitted a response letter supporting its proposal and responding to Comment Letter No. 2.[9] For the reasons discussed below, the Commission has decided to approve the CHX's proposal.

II. Description of the Proposals

CHX Rule 3, Article VI authorizes the Exchange to require the successful completion of an examination in connection with the registration of partners, officers, options principals, branch office managers and registered representatives of member firms and member corporations. Pursuant to this Rule, in 1987 the Commission approved the use of the General Securities Registered Representative Examination (''Series 7 Exam'') by the CHX to qualify persons seeking registration as general securities representatives. The purpose of the proposed rule change is to: (1) Adopt the requirement that members located on the floor of the CHX who wish to accept orders directly from the public must take and pass the Series 7 Exam; (2) allow members located on the floor of the CHX to accept orders directly from professional customers [10] for execution on the trading floor without taking the Series 7 Exam so long as they take and pass the Series 7A Exam; (3) allow floor clerks/floor employees to accept orders from professional customers in support of members or member organizations previously approved to conduct a public business so long as they take and pass the Series 7B Exam; [11] (4) codify the existing requirement that all potential floor members successfully complete a ''Floor Membership Exam''; (5) codify the existing requirement that all potential market makers successfully complete a ''Market Maker Exam'' in addition to the Floor Membership Exam; and (6) codify the existing requirement that all potential co-specialists successfully complete a ''Co-Specialist'' Exam in addition to the Floor Membership Exam.

The proposed rule change also clarifies current Exchange requirements for registering personnel and makes technical changes to the registration procedure. The proposed rule change adds a definition of ''control person'' to Article VI, Rule 2 and specifies that all such persons at members and member organizations must be acceptable to the Exchange. A ''control person'' is defined as:

> [A] person with the power, directly or indirectly, to direct the management or policies of a company whether through ownership of securities, by contract or otherwise, and at a minimum, means all directors, general partners or officers exercising executive responsibility (or having similar status or functions), all persons directly or indirectly having the right to vote 5% or more of a class of a voting security or having the power to sell or direct the sale of 5% or more of a class of voting securities, or in the case of a partnership, having the right to receive upon dissolution, as having contributed, 5% or more of the capital.[12]

Additionally, the proposed change clarifies that nominees of member firms must be registered with the Exchange.

Rule 2 of Article VI requires members of member organizations that know or in

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] See Letter from David T. Rusoff, Foley & Lardner, to Elisa Metzger, SEC dated March 14, 1996 (''Amendment No. 1'').

[4] See Letter from Charles R. Haywood, Foley & Lardner, to Elisa Metzger, SEC dated April 4, 1996 (''Amendment No. 2'').

[5] The Exchange will use the Series 7A Examination and the respective Content Outline that was approved in Securities Exchange Act Release No. 32698 (July 29, 1993), 58 FR 41539 (File No. SR–NYSE–93–10). The Exchange will use the Series 7B Examination and the Respective Content Outline that was approved in Securities Exchange Act Release No. 34334 (July 8, 1994) 59 FR 35964 (File No. SR–NYSE–94–13). The Series 7A and 7B Examinations for CHX members will be administered by the National Association of Securities Dealers, Inc. (''NASD'').

[6] See Letter from C. Philip Curley, Robinson Curley & Clayton, P.C., to Jonathan G. Katz, Secretary, SEC dated May 2, 1996 (''Comment Letter No. 1'').

[7] See Letter from David Rusoff, Foley & Lardner, to Elisa Metzger, SEC dated May 31, 1996 (''Amendment No. 3'').

[8] See Letter from C. Philip Curley, Robinson Curley & Clayton, P.C., to Jonathan G. Katz, Secretary, SEC dated July 15, 1996 (''Comment Letter No. 2'').

[9] See Letter from David Rusoff, Foley & Lardner, to Elisa Metzger, SEC dated July 24, 1996.

[10] The proposal defines a professional customer to include: A bank; trust company; insurance company; investment trust; state or political subdivision thereof; charitable or nonprofit educational institution regulated under the laws of the United States or any state or pension or profit sharing plan subject to ERISA or of an agency of the United States or of a state or a political subdivision thereof; or any person who has, or has under management, net tangible assets of at least sixteen million dollars. As used in this definition, the term ''person'' would not include natural persons.

[11] To minimize any burden imposed by the Series 7, Series 7A and Series 7B exam requirements, the Exchange will phase-in these new requirements over a designated period of time after the proposed rule change has been approved. This will provide persons subject to the exam with an opportunity to study for and take the new examination without unnecessary business disruptions. The phase-in period is as follows: Members who were not required to successfully complete the Series 7 or Series 7A exam prior to approval of this rule change and floor clerks/floor employees subject to the Series 7B exam will have 180 days from the effective date of this proposed rule change to take the appropriate exam. In the event the member or floor clerk/floor employee fails such examination, such member or floor clerk/floor employee must, nonetheless, successfully complete such examination within 270 days from the effective date of this proposed rule change.

[12] In the original filing, the proposed amendment required that all control persons and certain shareholders be acceptable to the Exchange. Amendment No. 3 deleted the reference to ''certain shareholders'' and amended the definition of ''control person'' to include those persons who directly or indirectly have the right to vote or sell 5% or more of a class of voting security, as opposed to 10% or more of a class of voting security. Amendment No. 3 also clarified that in the case of a partnership, a ''control person'' would include those persons who have the right to receive upon dissolution, as having contributed 5%, as opposed to 10%, or more of the capital.

the exercise of reasonable care should know that any prospective employee is subject to one or more statutory disqualifications to submit details on such prospective employee to the Exchange and receive Exchange approval before such person becomes associated with the member or member organization. Rule 2 also requires that each member or member organization take reasonable care to determine the existence of a statutory disqualification prior to employing any prospective employee. Further, if any person already employed by a member or member organization thereafter becomes subject to a statutory disqualification, notice must be sent to the Exchange promptly. Amendment No. 3 clarifies that these provisions are applicable to control persons as well as employees of members or member organizations.

Rule 2 of Article VI states that ''[e]very other employee of a member or member organization must also be acceptable to the Exchange.'' Amendment No. 3 explains the application of the standard ''acceptable to the Exchange'' to control persons. In the proposed rule change, the Exchange states that the ''acceptable to the Exchange'' standard will apply to control persons in the same manner as it has applied that standard to employees of members or member organizations in the past since the rule was first adopted.[13] The filing also makes technical changes to Rule 2 of Article VI. In this regard, the filing changes the term ''Form B/D'' to ''Form BD,'' changes ''Schedule D'' to Schedule DRP,'' and changes ''Series VII'' to ''Series 7'' to conform to recent changes in the names of those forms. In addition, the filing changes the term ''exchange'' to ''self-regulatory organization'' in order to include within the language of the rule self-regulatory organizations that do not meet the statutory definition of ''exchange,'' such as the National Association of Securities Dealers.[14] The filing moves Interpretation and Policy .01, .02, and .03 from Rule 3 of Article VI to Rule 2 of that Article[15] and moves the location of a portion of Interpretation and Policy .02(b) of Rule 2 relating to options to another location in the same interpretation. The proposed rule change revises Interpretation and Policy .01 (2) of Rule 2, Article VI to delete the requirement that a Notice of Acceptance of Registration Form from the NASD be submitted to the Exchange because this form no longer exists. The proposed rule change also deletes Interpretation and Policy .01(3) of Rule 2, Article VI because revised Interpretation and Policy .01 gives the Exchange the authority to permit firms to submit revised forms directly to any SRO. Thus, the carve-out for NYSE member firms provided for in this interpretation is no longer needed.[16]

The proposed rule change also revises Rule 2 of Article VI, Interpretation and Policy .01 to clarify the procedures to be followed when registering persons with the Exchange. Specifically, a member firm that registers persons with the Exchange must submit, among other things, a completed Form U–4 for such individual to the Exchange (or to another SRO designated by the Exchange). The member firm must also submit an amended Form BD for the firm if the individual's registration requires the Form BD to be amended. Additionally, the member firm must update its Form BD and Form U–4s whenever information on those Forms becomes inaccurate or incomplete.

Finally, the filing proposes to amend Rule 3 of Article VI to clarify that the examinations and training courses required by the rule apply to individual members as well as persons at member firms and member organizations.

III. Summary of Comments

The Commission received two comment letters regarding the amendments to Article VI, Rule 2, regarding the registration requirements for personnel. As stated above, in the original filing, the proposed amendment to Article VI, Rule 2, would have required that ''Every other employee of, any control person, and certain shareholders of, a member or member organization must also be acceptable to the Exchange.'' In Comment Letter No. 1, the commenter stated that the term ''certain shareholders'' was not defined. In addition, the commeter stated that the phrase ''acceptable to the Exchange'' was too vague a standard. In response, the CHX amended the original filing and deleted the term ''certain shareholders.'' In the amended filing, the CHX provided examples of circumstances in which an individual would not meet the ''acceptable to the Exchange'' requirement.[17]

In comment Letter No. 2, the commenter re-asserted its comment that the ''acceptable to the Exchange'' language is too vague. In response to Comment Letter No. 2, the CHX claims that Comment Letter No. 2 restates some of the same concerns that were raised in Comment Letter No. 1 and that the CHX believes it fully addressed those comments in the amended filing.

Dissussion

After careful consideration of the comments and the CHX response thereto, the Commission has determined to approve the proposed rule change. For the reasons discussed below, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with the requirements of Sections 6(b)(5) and 6(c)(3)(B) of the Act.[18] In particular, the Commission believes the proposal is consistent with the Section 6(b)(5) requirements that the rules of an exchange be designed to promote just and equitable principles of trade, remover impediments to and perfect the mechanism of a free and open market and a national market system, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public. Section (6)(c)(3)(B) provides that a national securities exchange may examine and verify the qualifications of an applicant to become a person associated with a member in accordance with procedures established by the rules of the exchange, and require any person associated with a member, or any class of such persons, to be registered with the exchange in accordance with procedures so established.

The Commission also believes that the proposed rule changes are consistent with Section 15(b)(7) of the Act,[19] which stipulates that prior to effecting any transaction in, or inducing the purchase or sale of, any security, a registered broker or dealer must meet certain standards of operational capability, and that such broker or dealer (and all natural persons associated with such broker or dealer)

[13] While the Exchange has not had to apply this standard in recent years, the Exchange might apply it if, for example, a prospective employee or control person is subject to a statutory disqualification or if the person, while not subject to a statutory disqualification, is barred from the banking industry because he or she stole from customers. See supra note 7.

[14] The term ''self-regulatory organization'' is to have the statutory meaning. See Amendment No. 2.

[15] In Interpretation and Policy .02, the change from ''would be'' to ''are'' is a stylistic change intended to make no substantive alteration in the rule. See Amendment No. 2.

[16] In the original filing, the proposed amendments to Rule 2 of Article VI stated that upon notice to a member or member organization that the President of the Exchange has withheld or withdrawn approval of the employment of any other person, the relationship between the member or member organization and such person shall be terminated. Amendment No. 3 deletes the reference to ''the employment of'' any such other person.

[17] See supra note 13.

[18] 15 U.S.C. 78f(b)(5) and (c)(3)(B).

[19] 15 U.S.C. 78o(b)(7).

must meet certain standards of training, experience, competence, and such other qualifications as the Commission finds necessary or appropriate in the public interest or for the protection of investors.

Series 7, Series 7A, and Series 7B Exams

The proposed interpretation and policy to Rule 3 of Article VI will clarify and put all persons on notice that any person who conducts a public business is required to be registered and qualified as a registered representative. Such registration would require, among other things, that a person complete the Series 7 Exam, as described in Interpretation and Policy .01(d) to Rule 3 of Article VI. Likewise, the proposed interpretation and policy will put all persons on notice that any person who accepts orders directly from professional customers for execution on the trading floor is required to complete a Series 7A Exam or Series 7B Exam.

The Commission believes that the Series 7A Exam and Series 7B Exam requirements should help to ensure that only those floor members and floor clerks/floor employees with a comprehensive knowledge of Exchange rules, as well as an understanding of the Act, will be able to conduct a public business limited to accepting orders directly from professional customers for execution on the trading floor. The Commission has determined that the Content Outlines for the Series 7A Exam and the Series 7B Exam are sufficiently detailed and cover the appropriate information so as to provide an adequate basis for studying the topics covered on the Exam.[20] These outlines should help to ensure that those persons taking the Series 7A Exam or Series 7B Exam fully understand the subject matter of those exams.

The Commission has determined that the proposed limited registration requirements for floor members and floor clerks/floor employees who accept orders from professional customers is reasonable and is consistent with the requirements of Sections 6(b)(5) and 6(c)(3)(B) of the Act. These new categories of registration would permit only those floor members and floor clerks/floor employees who have demonstrated adequate skills and knowledge to conduct a public business which is generally limited to accepting orders directly from professional customers, as defined in the interpretation and policy,[21] for execution on the trading floor. The CHX has argued that the level of knowledge, skills and abilities necessary to conduct such business is less than that needed to conduct a full service business with retail customers. The Commission believes that, because the CHX will ensure that floor members handling professional customer business are adequately qualified through the use of either the Series 7 Exam, Series 7A Exam, or Series 7B Exam, it is consistent with the CHX's regulatory responsibilities to establish this category of limited registration.

General Membership, Market Maker, and Co-specialist Exams

The Commission believes that codification of the existing requirements that all: (1) Potential floor members successfully complete the Floor Membership Exam; (2) potential market makers successfully complete the Market Maker Exam in addition to the Floor Membership Exam; and (3) co-specialists successfully complete the Co-specialist Exam, will clarify and put all such persons on notice of such requirements. In addition, the Commission believes that these exams will help to ensure that only those members with basic trading knowledge and ability will have a floor presence. Similarly, the Market Maker Exam and the Co-specialist Exam should help to ensure that only those members that have an understanding of market makers' and co-specialists' duties and obligations will be permitted to conduct such functions.

Registration of Personnel

The Commission has determined that the proposal that nominees of member firms must be registered with the Exchange is consistent with Section 6(c)(3)(B) of the Act, which permits a national securities exchange to examine and verify the qualifications of an applicant to become a person associated with a member, and require any such person to be registered with the exchange in accordance with procedures so established.

The Commission also believes that the requirement that any ''control person'' must be acceptable to the Exchange is consistent with Section 15(b)(7) of the Act[22] which stipulates that all natural persons associated with a registered broker or dealer must meet certain standards of training, experience, competence, and such other qualifications as the Commission finds necessary or appropriate in the public interest or for the protection of investors. While Comment Letters No. 1 and 2, assert that this is too vague a standard, all employees of members or member organizations currently are subject to this standard. Amendment No. 3 would hold control persons to the same standard as other employees. Further in Amendment No. 3, the Exchange described the parameters of this standard. For example, the Exchange would find a person unacceptable if such person was barred from the banking industry because he or she stole from customers. The Commission has determined that the Exchange has adequately addressed the commenter's criticism of this provision.

The proposal also requires that a member or member organization must take reasonable care to determine the existence of a statutory disqualification of any prospective control person, report any such statutory disqualifications of prospective control persons to the Exchange, submit details on the statutory disqualification of the prospective control person to the Exchange, and receive Exchange approval before such person becomes associated with the member or member organization. Further, if any control person already employed by a member or member organization becomes subject to a statutory disqualification, notice must be sent to the Exchange promptly. The Commission believes this is consistent with Section 6(c)(3)(B) of the Act in that the CHX is verifying the qualifications of a person associated with a member or member organization.

The Commission has determined that the technical changes to Rules 2 and 3 of Article VI are consistent with the requirements of Section 6(b)(5) of the Act in that such changes merely update the rules to conform to current industry practice. For example, the filing changes the term ''Form B/D'' to ''Form BD,'' and changes ''Schedule D'' to ''Schedule DRP'' to conform to recent changes in the names of those forms.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[23] that the proposed rule change (SR–CHX–96–11), including Amendments No. 1, 2, and 3, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[24]

Jonathan G. Katz,

Secretary.

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[20] See supra note 5.

[21] See supra note 10.

[22] 15 U.S.C. 78o(b)(7).

[23] 15 U.S.C. 78s(b)(2).

[24] 17 CFR 200.30–3(a)(12).