

Test Alert!

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series **31**

The information included in this release, in addition to your other Kaplan Financial materials, is designed to assist you in preparing for concepts that your exam may include. We urge you to read it carefully and take time to review the sample questions and rationale.

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As always, we strive to provide you with the most current test preparation information. If you have any questions about this or any other Kaplan Financial study material, please call AnswerPhone at 1-800-621-9621, ext. 3598 between the hours of 8 AM and 6 PM CT, Monday through Friday.

KAPLAN FINANCIAL

The information below has been updated since the 2nd edition of the Dearborn Financial Series 31 License Exam Manual. This information is incorporated in the 1st edition of the Kaplan Financial License Exam Manual.

ESTABLISHING ANTI-MONEY LAUNDERING PROGRAMS

The USA PATRIOT Act amended the Bank Secrecy Act to require that financial institutions establish anti-money laundering (AML) programs. FCMs, CPOs, and CTAs are now included in the definition of financial institutions in the BSA. IBs are considered to be “brokers or dealers in commodities” within the financial institution definition.

An AML program must be in writing and must include:

- the development of internal policies, procedures, and controls;
- the designation of a compliance officer;
- an ongoing employee training program; and
- an independent audit function to test programs.

Discretionary Accounts

An associate of a commodities member firm may not exercise discretion over a customer’s commodity futures account unless the representative has been continuously registered and worked in that capacity for a at least two years. This requirement does not apply for those registered as a CTA.

High-Pressure Sales

Compliance Rule 2-29 prohibits the use of high-pressure sales practices, but it does not define high-pressure sales practices. However, there has been a significant number of NFA enforcement cases prosecuted under the rule which illustrate the types of practices that have been found to constitute high-pressure sales.

A common characteristic of many high-pressure sales is the undue sense of urgency that the associated person conveys to the customer. The associated person is asking the customer to act now and think later.

Abuses include:

- rushing customers through the account opening forms and glossing over the risk disclosure in haste to open the account;

- actively attempting to dissuade unsophisticated customers from seeking further advice on their investment decision from friends, relatives, and other financial advisers;
- threatening or intimidating customers;
- a pattern of telephone calls that are unusual in their timing or frequency (i.e., barraging customers with calls late at night or early in the morning); and
- shouting at customers, using profane language, or otherwise attempting to bully the customer into opening an account.

Rule 2-29 also addresses the content of promotional material and other communications members have with public customers. Among sales or educational literature, print and electronic advertising, phone solicitations, and sales scripts, it also covers Internet material. The rule requires, among other things, that:

- statements made be factually true;
- statements concerning the possibility of profit be balanced by equally prominent statements of the risk of loss;
- hypothetical results not be presented for any trading program for which the member has on hand at three months or better of actual trading results;
- past results are not necessarily indicative of future results; and
- opinions be identified as such.

The rule prohibits the use of any promotional material that:

- states that futures trading is appropriate to everyone;
- is likely to deceive or mislead the reader;
- uses or is part of a high-pressure sales approach;
- omits any fact that might make the material misleading or deceptive.

Significant Sales Practice Problems in Employment History

NFA Rule 2-9 is one of the National Futures Association (NFA) rules designed to prevent abusive sales practices. It gives the members the responsibility for diligently supervising its employees' sales practices.

Member firms identified as having a sales force that has received questionable training in sales practices are required to meet certain criteria established by the board and adopt specific supervisory procedures designed to prevent abusive sales practices. Subsection b covers all activities regulated by NFA, including the off-exchange retail Foreign Exchange (forex) activities of members subject to NFA Compliance Rule 2-36.

The employment history of a member's sales force is relevant in identifying firms with potential sales practice problems. Member firms in this situation must have stringent supervision procedures in place to ensure that its associated persons' improper training does not corrupt their sales efforts.

The NFA has determined that a member will be required to adopt the special supervisory procedures over its sales practice activities if:

- for firms with fewer than five associated persons, two or more of them have been employed by one or more disciplined firms (firms or member firms that have been disciplined by the NFA, the Commodities Futures Trading Commission [CFTC], any securities industry self-regulatory organization, or the Securities and Exchange Commission [SEC] for sales practice fraud or matters involving security futures products);
- for firms with at least five but fewer than 10 associated persons, 40% or more of its associated persons have been employed by one or more disciplined firms;
- for firms with at least 10 but fewer than 20 associated persons, four or more of its associated persons have been employed by one or more disciplined firms; or
- for firms with at least 20 associated persons, 20% or more of its associated persons have been employed by one or more disciplined firms.

A disciplined firm is a firm that meets the following criteria:

1. The firm has been formally charged by either the CFTC or NFA with deceptive telemarketing practices or promotional material
2. Those charges have been resolved
3. The firm has been permanently barred from the industry as a result of those charges

Tape-Recording Phone Calls

Member firms meeting the criteria will be required to tape-record all telephone conversations between their associated persons and both existing and potential customers, including existing and potential retail forex customers of members subject to NFA Compliance Rule 2-36. Tape-recording these conversations is the best way to monitor the activities of associated persons and provides the members with complete and immediate feedback on each associated person's method of soliciting customers.

Members required to tape-record conversations must do so for two years and must retain the tapes for five years. The tapes must be readily accessible during the first two of the five years.

For two years, member firms meeting the criteria will be required to file all promotional material, as defined in NFA Compliance Rule 2-29, with NFA at least 10 days prior to its first use.

Members required to adopt enhancement procedures may seek a waiver of the enhanced supervisory requirement upon showing that the member's current supervisory procedures provide effective supervision over its employees, including enabling the member to identify potential problem areas before customer abuse occurs.

If a member meets the criteria and trades security futures products, the member firm must also show that the member's supervisory procedures ensure compliance with all applicable securities laws and regulations.

Some of the factors that the three-member waiver committee may consider in evaluating a waiver request include:

- the total number of associated persons sponsored by the member;
- the number of branch offices and guaranteed introducing brokers (GIBs) operated by the member;
- the experience and background of the member's supervisory personnel;
- the number of the member's associated persons who had received training from firms which have been closed for fraud, the length of time those associated persons worked for those firms, and the amount of time that has elapsed since those associated persons worked for the disciplined firms;
- the results of any previous NFA examinations; and
- the cost effectiveness of the taping requirement in light of the firm's net worth, operating income, and related telemarketing expenses.

Email

Members must supervise the use of futures-related email by employees as they supervise other forms of correspondence. Email supervision procedures must be in writing and identify, by title or position, the person responsible for conducting the review.

Firms may wish to consider whether the following procedures would be appropriate as well:

- Specify how and with what frequency emails will be reviewed and how that review will be documented
- Categorize what type of email will be pre-reviewed or post-reviewed

Firms dealing with individual, relatively unsophisticated retail customers might consider using a larger sample or even reviewing all the routine email. A firm may wish to conduct a comprehensive review of employees' and agents' email if they have a disciplinary history involving problems with customers or came from a firm that has been disciplined for fraud.

Trading Based on Material, Nonpublic Information (CFTC/SEC)

CFTC regulations and NFA and exchange rules do not generally prohibit trading futures based on material, nonpublic information; SEC rules do.

However, NFA Rule 2-37(a) prohibits members registered with the SEC as broker/dealers and representatives from violating regulations regarding trading on material, nonpublic information in connection with security futures products. Insider trading and other forms of trading based on material, nonpublic information that violate SEC rules would also be a violation of NFA Rule 2-37.

Members may not purposefully establish, increase, decrease, or liquidate a position in any security futures product in anticipation of the issuance of a research report regarding the underlying security or a derivative based primarily on the underlying security (including the security futures product itself).

Members should isolate specific information within research departments of the firm using firewalls to prevent the trading department from acting on the advance knowledge of research reports. Firms that do not create firewalls must demonstrate that the position was not changed in anticipation of the issuance of a research report.

Part II

Changes Since the Kaplan Financial Series 31, 1st Edition

Below is information regarding changes in rules and regulations that have been approved or expanded and clarified since the Kaplan Financial Series 31, 1st edition was published. These changes will be incorporated in the next edition of the License Exam Manual.

No new changes to report at this time.

Part III

New Sample Questions

1. To offset a long futures contract, an investor may
 - A. make delivery of the actual
 - B. accept delivery of the actual
 - C. buy a futures contract
 - D. sell a futures contract

2. Which of the following can NOT be a member of a futures clearing-house?
 - A. A corporation
 - B. Trading member firms
 - C. Nonmembers of the exchange
 - D. Agricultural cooperatives

3. An individual who solicits orders, funds, or customers on behalf of a CPO, CTA, FCM, or IB must be registered as an associated person.
 - A. True
 - B. False

Part IV

Answers and Rationales

1. **D** To offset a long futures position, the investor must do the opposite. In this case, the investor must short (sell) a futures contract.
2. **C** To be a member of a clearinghouse requires membership in the exchange—often multiple memberships on that exchange.
3. **A** The CFTC requires APs to register. An AP is defined by the commission in part as any person who is associated with a CPO in soliciting funds or securities for participation in a commodity pool.

To submit comments or suggestions, please send an email to errata@kaplan.com.

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