

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Continuing Education
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KEY TOPICS

Registration
Research Reports

GUIDANCE

Research Analysts and Research Reports

SEC Approves New NASD Research Analyst Qualification and Examination Requirements (Series 86/87); **Effective Date: March 30, 2004**

Executive Summary

The Securities and Exchange Commission (SEC) recently approved amendments to NASD rules to finalize and implement the research analyst registration requirements and examination program. The registration requirements become effective on March 30, 2004. As of that date, any associated person who functions as a research analyst must pass the new Research Analyst Qualification Examination (Series 86/87) or qualify for an exemption or waiver. The examination consists of an analysis part (Series 86) and regulatory part (Series 87). Prior to taking either the Series 86 or 87, a candidate must also have passed the General Securities Registered Representative Examination (Series 7), the Limited Registered Representative (Series 17), or the Canada Module of Series 7 (Series 37 or 38). Persons who are functioning as research analysts on the effective date will be granted a one-year grace period within which to meet the registration requirements, provided the member firm with which they are associated applies for the research analyst registration within **60** days of the effective date of the rule. There is no "grandfather" provision for this new qualification requirement.

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Philip Shaikun, Associate General Counsel, Regulatory Policy and Oversight, at (202) 728-8451; or Carole Hartzog, NASD Testing and Continuing Education Department, at (240) 386-4678.

Background and Discussion

Qualification Requirements

NASD Rule 1050 requires any person associated with a member who functions as a research analyst to be registered as such and pass a qualification examination. In the context of this new qualification requirement, a research analyst is “an associated person who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report.”

NASD intends for the term “research report” in Rule 1050 to be defined as it is in Rule 2711(a)(8), which applies only to “equity securities” as that term is defined in Section 3(a)(11) of the Exchange Act of 1934. Accordingly, fixed income analysts do not need to be registered as research analysts.

Prerequisite Examination

Prior to sitting for either part of the Research Analyst Qualification Examination, a candidate must be registered pursuant to NASD Rule 1032 as a General Securities Representative and have passed or received a waiver from either the General Securities Registered Representative Examination (Series 7), the Limited Registered Representative (Series 17), or the Canada Module of Series 7 (Series 37 or 38).

Grace Period

All associated persons who currently function as research analysts must pass the required examinations to continue to function in that capacity. The new qualification requirement for Research Analysts does **NOT** have a “grandfather” provision. NASD believes that all persons functioning as research analysts should demonstrate the same requisite analytical competency level and knowledge of applicable laws, rules, and regulations.

However, candidates who are functioning as research analysts on the effective date of March 30, 2004, will be allowed one year to meet the research analyst registration requirements. The one-year grace period is intended to provide these analysts sufficient time to study and pass the examination(s) without causing undue disruption in carrying out their responsibilities to their member firm and its customers.

To avail a research analyst of this grace period, the member firm must submit to NASD a registration application (or amendments thereto) for the research analyst, as described below, before **May 31, 2004**. These research analysts would then have until April 4, 2005, to pass the necessary examination(s). Should a research analyst fail to pass the exam within the one-year grace period, his or her registration as a research analyst will terminate on April 4, 2005. Those individuals who apply for registration as research analysts after May 31, 2004, will be subject to NASD's normal qualification procedure. That is, such candidates must have passed either the Series 7, Series 17, or the Series 37 or Series 38 Exam, as well as the new Series 86/87 Exam, *before* functioning as Research Analysts.

Retaking Failed Exams

The usual policy regarding waiting periods for candidates retaking a failed exam has been modified for candidates subject to the one-year grace period described above. Typically, a candidate must wait 30 days before retaking a failed exam and 180 days after the third and all subsequent failures. Candidates who qualify for the research analyst one-year grace period (*i.e.*, those persons functioning as research analysts on March 30, 2004 whose member firm submits to NASD a registration application (or amendments thereto) for the research analyst before May 31, 2004) must wait 30 days before retaking a failed Series 86 and/or Series 87 Exam, but will not be subject to any 180 day waiting period irrespective of whether the candidate fails an exam three times or more. This special exemption from the usual waiting period rules applies only to those candidates eligible for the grace period for Research Analyst Qualification Examination and only for the duration of the grace period. The usual waiting periods apply in all other circumstances, including those instances where a research analyst must pass either the Series 7, Series 17, Series 37, or Series 38 exam within the one-year grace period.

Exemptions

A research analyst who has passed both **Level I and Level II of the Chartered Financial Analyst (CFA) Examination** that is administered by the Association for Investment Management and Research (AIMR) may request an exemption from Part I (Series 86), the Analysis section of the Research Analyst Qualification Examination. To be eligible for the exemption, an applicant must have passed Levels I and II of the CFA examination and must either (1) have functioned continuously as a research analyst since having passed Level II of the CFA examination or (2) have passed Level II of the CFA examination within two years of application for registration as a research analyst.

In addition to the registration procedures described below, member firms will also be required to request the exemption in writing for eligible candidates. To request the exemption, the member must submit the following candidate information to the NASD Testing and Continuing Education Department via e-mail at RSCFA@nasd.com:

Candidate's name (Last, First, Middle Initial)

Candidate's CRD Number

Candidate's Birth Date (MM/DD/YR)

Broker/Dealer Name and CRD#

NASD staff will then contact AIMR to confirm the candidate's eligibility. Upon receipt of a positive response from AIMR, the exemption from the Series 86 will be posted to the candidate's CRD record and notification will be sent to the member firm. Candidates who have not completed the required CFA exams will be required to pass both the Series 86 and 87. For candidates seeking a Series 86 exemption, note that registration approval will not be posted until the candidate also passes the Series 87.

Exam Content

The qualification exam consists of two parts. Part I – Analysis (Series 86) consists of 100 multiple-choice questions that primarily test fundamental analysis and valuation of equity securities. Part II – Regulatory Administration and Best Practices (Series 87) consists of 50 multiple-choice questions that cover relevant federal and industry rules and regulations. Candidates are allowed 240 minutes to complete Part I and 90 minutes to complete Part II. Candidates may take Parts I and II in any order and may schedule the examinations on the same or different days. Since multiple forms of the examination will be administered, the passing score for the Series 86 and 87 will fluctuate moderately from examination to examination. Candidates will be given an informational breakdown of their performance on each of the sections, along with their overall score and grade at the completion of exam session.

A study outline has been prepared to assist member firms in preparing candidates for the Research Analyst Qualification Examination and is available at www.nasdr.com/analyst_guide.asp. Members may wish to use the study outline to structure or prepare training material, develop lecture notes and seminar programs, and as a training aide for the candidates. The study outline and test are divided into four topical sections, which are described below along with the number of questions from each section:

Section	Description	Number of Questions
	Part I: Series 86—Analysis	
1	Information and Data Collection	10
2	Analysis, Modeling and Valuation	90
	Part II: Series 87—Regulatory Administration and Best Practices	
3	Preparation of Research Reports	32
4	Dissemination of Information	18
	Total	150

The 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 pool of questions for this examination within a reasonable time period of the effective dates of those rules. Questions on rescinded rules will be promptly deleted from the pool of questions. Candidates will only be asked questions pertaining to rules that are effective at the time they take the exam.

The test is administered as a closed-book exam. Severe penalties are imposed on candidates who cheat on NASD-administered examinations. The proctor will provide scratch paper and a *basic electronic calculator* to candidates. These items must be returned to the proctor at the end of the session.

The Research Analyst Qualification Examination will be administered at conveniently located test centers operated by Pearson and Prometric professional testing center networks. Appointments to take the examinations can be scheduled through either network:

- ▶ Pearson Professional Centers: contact Pearson VUE’s National Registration Center at **1-866-396-6273 (toll free)**, or **1-952-681-3873 (toll number)**.
- ▶ Prometric Testing Centers: contact Prometric’s National Call Center at **1-800-578-6273 (toll free)** or go to www.2test.com for Web-based scheduling.

Registration Procedures

A Uniform Application for Securities Industry Registration or Transfer Form (Form U4) must be submitted to NASD via Web CRD in order to register an individual as a Research Analyst. For persons already registered in one of the prerequisite categories, the member need only submit page one of Form U4 to request the Research Analyst (RS) registration. For new employees, a member must submit a full Form U4 application to request all necessary registrations and any other documents required for registration. The exam fees are \$150 for the Series 86 and \$100 for the Series 87; the registration fee for new applicants is \$85. To obtain the one-year grace period described above, the member firm must request the *RS* registration before **May 31, 2004**. It is possible that a candidate who is within the one-year grace period may transfer to another member firm. If so, the grace period will continue to be available to the candidate, and the candidate will continue to be allowed until April 4, 2005, to pass the examination.

Effective Date

The registration and qualification requirements for research analysts become effective on March 30, 2004.

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Research Analyst Examination Frequently Asked Questions

Definition of Research Analysts under Rule 1050

- Q. Who needs to take this exam?
- A. Any associated person of a member who is primarily responsible for the preparation of the substance of a research report on equity securities or whose name appears on a research report on equity securities. For the purposes of determining who needs to register as a research analyst, the term "research report" has the same meaning as it does in Rule 2711(a)(8): "a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision." Members should refer to *Notices to Members 02-39* and *04-18* for interpretation of the definition of a "research report" under 2711(a)(8).
- Q. We have many analysts in our BD/IA firm who both educationally and through industry experience qualify as investment analysts and have passed Series 6, 7, 63, and 65. Would they be "grandfathered" as research analysts?
- A. The research analyst registration requirement does not include a "grandfather" provision. All associated persons who meet the definition of a research analyst, new and incumbent, must satisfy the qualification requirements of NASD Rule 1050.
- Q. Are "sell-side" equity analysts required to register as research analysts and pass the Series 86/87?
- A. Yes. The registration and qualification requirements of Rule 1050 do not distinguish between "sell-side" and "buy-side" analysts. Any person who prepares written or electronic communications that includes an analysis of equity securities and sufficient information upon which to base an investment decision would be required to register as a research analyst.
- Q. Would individuals who prepare research for a member firm as consultants be subject to the requirements of NASD Rule 1050?
- A. If the consultant is an "associated person" under NASD rules and his or her activities fall under the definition of "research analyst" pursuant to Rule 1050, the consultant would have to register as a research analyst.

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- Q. Does this requirement apply to everyone who works in equity research or just those who write a research report that will be seen by the public?
- A. Rule 1050 applies to associated persons who prepare publicly disseminated research reports. Associated persons who prepare reports for use only by a member's sales force, money managers, or other employees of the firm, and who do not have reason to believe that the reports will be redistributed publicly, would not be subject to this rule.
- Q. Is a "technical analyst" who does not rely on fundamental research to prepare his or her research reports on companies required to register as a research analyst and take the qualification examinations?
- A. As explained in the joint memoranda issued by NASD and the NYSE in *Notice to Members 02-39* and *04-18*, a communication that consists of "technical analysis concerning the demand and supply for a sector, index, or industry based on trading volume and price" falls outside the definition of a "research report" under Rule 2711(a)(8). Accordingly, a person who produces only such technical research would not be required to become registered as a research analyst. However, the exclusion does not extend to technical analysis of individual securities. Thus, an associated person who produces technical research on individual companies would be required to become registered as a research analyst pursuant to Rule 1050.
- Q. Is a research analyst who is employed by a foreign broker/dealer affiliate of an NASD member required to register pursuant to Rule 1050 if the member uses that analyst's research reports or distributes in the United States in accordance with SEC Rule 15a-6?
- A. A "research analyst" employed by a non-member affiliate of an NASD member is not required to register as a research analyst pursuant to Rule 1050 unless the research analyst is an "associated person" of the NASD member as that term is defined in the NASD By-Laws.

Exemptions and Waivers

- Q. What evidence will be required from a candidate who has passed the CFA Level I and II examinations?
- A. No evidence will be required. A member must submit electronically to NASD a request for the CFA exemption, and NASD will confirm the candidate's eligibility with AIMR.

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- Q. Can a research analyst who hasn't passed CFA Level I and II obtain a waiver from Series 86 if he has relevant employment or work experience? What types of employment/experience would qualify for this waiver?
- A. While NASD may grant waivers under extraordinary circumstances, in light of the purpose of the new research analyst qualification requirements, NASD does not intend to grant waivers except to those who have either passed the Series 86/87 or the CFA Levels I and II. Even those individuals who have a long history of functioning as a research analyst must meet the qualification requirements within one year of the effective date. A waiver might be considered for individuals who have passed the Series 86 and 87 and have substantial work experience as a research analyst, but who have let their registration lapse. Candidates who receive an exemption from, or waiver of, the Series 86 must still satisfy the Series 7, 17, 37, or 38 prerequisite and pass the Series 87 before becoming qualified as research analysts.
- Q. Can a request for an exemption (waiver) of the Series 87 be granted for someone who has Series 7, CFA Levels I, II, & III, and the NYSE Series 16?
- A. Waivers of the Series 87 will **NOT** be granted under any circumstances.

Supervision

- Q. What registration and qualification requirements must supervisors of registered research analysts possess?
- A. All registered NASD research analysts must be supervised by a Series 24 principal. Those members who are also members of the NYSE may continue to satisfy the principal approval requirements under Rule 2210(b)(1) with the signature or initial of a supervisory analyst (Series 16) approved pursuant to NYSE Rule 344. A Series 16 supervisory analyst may also supervise for compliance with the disclosure provisions of Rule 2711; however, a Series 24 principal must supervise all other conduct of a registered research analyst.
- Q. Will a Series 24 principal who supervises registered research analysts also be required to pass the Series 86/87?
- A. Not at this time. However, NASD is reviewing its supervision rules involving registered research analysts and may require supplemental qualification in the future. In the event that additional qualification requirements are required of supervisors of research analysts, NASD will provide sufficient time for such qualification so as not to disrupt a member's research business.