

Notice to Members

NOVEMBER 2004

SUGGESTED ROUTING

Continuing Education
Executive Representatives
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KEY TOPICS

Qualification Examinations
Registration
Research Reports
Rule 1050
Supervision

GUIDANCE

Research Analysts and Research Reports

SEC Approves New NASD Qualification Requirements for Supervisors of Research Analysts; **Compliance Date: No Later Than August 2, 2005**

Executive Summary

The Securities and Exchange Commission (SEC) has approved a new NASD rule that requires supervisors of equity research analysts to pass either the Series 87 or the New York Stock Exchange (NYSE) Series 16 Supervisory Analyst qualification examination. This new rule augments the existing requirement that supervisors of research analysts must be registered as a General Securities Principal. Members may apply for registration Research Principal (RP) through Web CRD beginning on April 4, 2005, and individuals must satisfy the qualification requirements by August 2, 2005. While the Series 16 and Series 87 are currently available, due to system constraints, the Research Principal (RP) registration category will not be available until April 4, 2005. The new rule language is attached as Attachment A.

Questions/Further Information

Questions concerning this *Notice* may be directed to Philip Shaikun, Associate General Counsel, Regulatory Policy and Oversight, at (202) 728-8451; Joe McDonald, Associate Director, NASD Testing and Continuing Education Department, at (240) 386-5065; or Carole Hartzog, Senior Analyst, NASD Testing and Continuing Education Department, at (240) 386-4678.

Background and Discussion

NASD Rule 1050 requires all persons associated with a member who function as research analysts to be registered as such with NASD and pass a qualification examination. Those individuals required to be registered as research analysts must pass the Research Analyst Qualification Examination (Series 86/87) or qualify for an exemption. That examination consists of two parts: Analysis (Series 86) tests fundamental analysis and valuation of equity securities; and Regulatory Administration and Best Practices (Series 87) tests knowledge of applicable rules and regulations, including NASD Rule 2711, NYSE Rule 344, and SEC Regulation AC.

For dual NASD/NYSE members, NASD currently permits either a Series 16 Supervisory Analyst or a Series 24 General Securities Principal to approve the *content* of research reports under the advertising rule (Rule 2210) and to review research reports for the applicable conflict of interest disclosures required by Rule 2711(h). If a dual member elects to have a Series 16 Supervisory Analyst approve the content of a research report, NASD requires a Series 24 General Securities Principal to supervise all other conduct of an individual who functions as a research analyst. NASD-only members are currently required to have a Series 24 General Securities Principal to both approve the content of research reports and supervise the conduct of research analysts. The General Securities Principal Qualification Examination Sales Supervisor Module (Series 23) is an acceptable alternative to the General Securities Principal Examination (Series 24).

The SEC has now approved amendments to NASD Rule 1022 to require supervisors of equity research analysts to pass the Series 87 or the Series 16.

Under the new rule NASD will permit dual NASD/NYSE members or NASD-only members to have the content of research approved by someone who has passed either (1) the Series 24 and the Series 87 or (2) the Series 16. If the member elects to have a Series 16 approve the content of research, then a Series 24 principal who has also passed either the Series 87 or the Series 16 must supervise the conduct of both the Series 16 Supervisory Analyst and the research analyst. Thus, the rule provides members with some flexibility in their supervisory structure for research analysts.

NASD believes this rule will promote investor protection by ensuring that persons responsible for approving research reports and for providing general supervision of the conduct of research analysts have demonstrable knowledge of Rule 2711 and related analyst conflict of interest laws, rules and regulations. At the same time, the rule preserves the longstanding NASD requirement that a General Securities Principal be responsible for the general conduct of a registered person.

All persons who supervise research analysts must satisfy these qualification requirements—there is no “grandfather” provision. However, NASD believes the compliance date of no later than August 2, 2005 provides adequate time for research supervisors to prepare for the examination and will avoid any disruption of the research desk.

NASD does not intend to grant waivers of the Series 87.

Registration Filing Requirements and Exam Fees

Beginning April 4, 2005, members may submit through Web CRD¹ a Uniform Application for Securities Industry Registration or Transfer Form (Form U4) to register as a Research Principal (RP) any person who functions in such capacity. Those individuals will then have until August 2, 2005 to pass the requisite examinations—the Supervisory Analyst (Series 16) or the Regulatory Administration and Best Practices part of the Research Analyst Exam (Series 87) in addition to the Series 23 or 24. The exam fees for the Series 87 and Series 16 are \$100¹ and \$200, respectively.

Currently, the Series 87 can only be scheduled when requesting registration as a Research Analyst and an exam window opens for both the Series 86 and Series 87. Due to system constraints, refunds of the Series 86 exam fee will not be provided to research principals who request the Series before April 4, 2005. Due to system constraints, the Research Principal registration category will be available on Web CRD effective April 4, 2005, at which time:

- ▶ Web CRD will accept requests for the Research Principal registration via page one of Form U4.
- ▶ The Series 87 will be a stand-alone examination *only* for purposes of the Research Principal registration.
- ▶ An NASD Supervisory Analyst registration category will be added to Web CRD (NASD-SA) for candidates who have passed the Series 16.

Research Principals who have passed the General Securities Principal exam and Series 16 or Series 87 before April 4, 2005 and whose registrations are current will have to request the registration category RP on or after April 4, 2005, and before August 2, 2005, by submitting a page 1 to the Form U4 on Web CRD.

Exam Content

The Series 87 qualification exam—Regulatory Administration and Best Practices—consists of 50 multiple-choice questions that cover relevant federal and industry rules and regulations. Candidates are allowed 90 minutes to complete the examination. Since multiple forms of the examination will be administered, the passing score for the Series 87 will fluctuate moderately from examination to examination.

The Series 16 consists of two parts: Regulatory Administration (Part I) and Securities Analysis (Part II). Part I consists of 50 multiple-choice questions that cover relevant NYSE rules, as well as the applicable provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Advisers Act of 1940. Candidates are allowed 90 minutes to complete this part. Part II consists of 50 multiple-choice questions that cover various topics pertaining to securities analysis, including accounting, economics, and fundamental and technical analysis, among others. Candidates are allowed 120 minutes to complete this part.

With respect to both the Series 87 and Series 16 examinations, 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 each exam session.

A study outline has been prepared to assist member firms in preparing candidates for the Series 87 examination and is available at www.nasdr.com/analyst_guide.asp. The content outline for the Series 16 is available at www.nyse.com/pdfs/series16.pdf. Members may wish to use the study outline to structure or prepare training material, or develop lecture notes and seminar programs, and as a training aide for the candidates.

The questions used in these examinations 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 these examinations 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 only will be asked questions pertaining to rules that are effective at the time they take the exam.

These tests are administered as closed-book exams. Severe penalties, up to and including expulsion from the industry, 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 Series 87 examination and Series 16 Supervisory Analyst examination are administered at conveniently located test centers operated by Pearson Vue 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)**, or go to www.pearsonvue.com/nasd for Web-based scheduling.
- ▶ Prometric Testing Centers: contact Prometric's National Call Center at **1-800-578-6273 (toll free)**, or go to www.prometric.com/nasd for Web-based scheduling.

Compliance Date

The registration and qualification requirements for supervisors of research analysts become effective on August 2, 2005. Any member firm whose Research Principal is not properly registered by that date will be in violation of NASD IM-1000-3 and Rule 1022(a)(5).

Frequently Asked Questions

1. **I am currently registered as a General Securities Principal. To qualify as a Research Principal (RP), will I be able to request the Series 16 exam in lieu of the Series 87 exam even if I am employed by an NASD-only member firm?**

Yes. Because Web CRD will recognize the Series 16 as a valid examination effective April 4, 2005, you should wait until then to request both the Series 16 exam and the RP registration.

2. **Since the Series 87 is currently being administered, can I sit for it now and receive the RP approval on April 4, 2005?**

Yes. However, if you open a window to take the Series 87 before April 4, 2005, you will be charged exam fees for both the Series 86 and 87 (due to system constraints that will be resolved effective April 4, 2005) and cannot obtain approval as a Research Principal because this registration category will not be available on Web CRD until April 4, 2005. If you choose to take the Series 87 before April 4, 2005, you will have to submit a page one of the Form U4 on Web CRD to request the "RP" registration after that date. Note that refunds of the Series 86 exam fee will not be provided. Effective April 4, 2005, you may open a window to take the Series 87 only.

3. **If a General Securities Principal fails the Series 16 or the Series 87, will there be a waiting period before the test can be retaken?**

The usual policy regarding waiting periods for candidates retaking a failed exam will apply to the Series 16 and Series 87 as well as the Series 23 and 24. Typically, a candidate must wait 30 days before retaking a failed exam and 180 days after the third and all subsequent failures.

4. **What happens if I do not pass the Series 16 or Series 87 by August 2, 2005?**

Since there is no grace period to satisfy this requirement, you will have to cease functioning as a Research Principal. If your firm has no other registered Research Principal, it will have to cease issuing research reports.

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5. If an individual supervises fixed income or municipal securities research analysts, do these new qualification requirements apply?

No. All supervisors of research analysts must be registered as principals in the category appropriate for their function. The new qualification requirements apply only to supervisors of *equity* research reports. Individuals who supervise fixed income analysts and approve fixed income research reports must have the Series 23 or 24 exam. Individuals who supervise municipal securities analysts and approve municipal securities research reports must have the Series 53 exam.

Endnote

- 1 The fee for the Series 87 examination will increase to \$105 beginning January 1, 2005. See *Notice to Members 04-73* (October 8, 2004)

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ATTACHMENT A

New language is underlined; deletions are in brackets.

1022. Categories of Principal Registration

(a) General Securities Principal

(1) through (4) No change.

(5) A person registered solely as a General Securities Principal shall not be qualified to supervise the conduct of a "research analyst" as defined in Rule 1050, or a supervisory analyst qualified pursuant to Rule 344 of the New York Stock Exchange who approves research reports on equity securities as permitted by Rule 2210(b)(1), unless such principal has passed a Qualification Examination as specified by the Board of Governors.