

Notice to Members

APRIL 2005

SUGGESTED ROUTING

Continuing Education
Executive Representatives
Legal & Compliance
Registration
Research
Senior Management
Training

KEY TOPICS

Qualification Examinations
Registration
Research Reports
Rule 1050
Supervision

GUIDANCE

Research Analysts and Research Reports

NASD Announces Exemption from the Research Analyst Qualification Requirements (Series 86 and 87) for Certain Employees of Foreign Affiliates Who Contribute to Member Research Reports

Executive Summary

NASD has amended NASD Rule 1050 to provide an exemption from the research analyst qualification requirements for certain research analysts employed by member foreign affiliates in jurisdictions that NASD and the New York Stock Exchange (NYSE) (together, SROs) have determined have acceptable qualification standards and research analyst conflict of interest rules. Currently, the exemption is available to research analysts in the following jurisdictions: the United Kingdom, China, Hong Kong, Singapore, Thailand, Malaysia, and Japan. Eligibility for the exemption is conditioned on several factors, including imposition of NASD Rule 2711 on foreign affiliates and their research analysts in those instances where the research analyst contributes to the preparation of a member's research report.

The amendment was filed on April 1, 2005, and became effective upon filing.

Questions/Further Information

Questions concerning this *Notice* may be directed to Philip Shaikun, Associate General Counsel, Regulatory Policy and Oversight, at (202) 728-8451.

Background and Discussion

NASD Rule 1050 requires an associated person who functions as a research analyst to register as such with NASD and pass a qualification examination. Rule 1050 is intended to ensure that research analysts possess a certain competency level to perform their jobs effectively and in accordance with applicable rules and regulations. In the context of this requirement, Rule 1050 defines “research analyst” as “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.” The term “research report” in Rule 1050 has the meaning as defined 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.”

Pursuant to Rule 1050, and in conjunction with the NYSE, NASD has implemented the Research Analyst Qualification Examination (Series 86/87). The examination consists of an analysis part (Series 86) and a regulatory part (Series 87). Prior to taking either the Series 86 or 87, a candidate also must 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 were functioning as research analysts on the effective date of March 30, 2004, and submitted a registration application to NASD by June 1, 2004, have until April 4, 2005, to meet the registration requirements.

Rule 1050 currently provides exemptions from the Series 86 examination for certain applicants who have passed Levels I and II of the Chartered Financial Analyst examination or have passed Levels I and II of the Chartered Market Technician Examination and produce only “technical research reports” as that term is defined in Rule 1050.

NASD has observed that members with global operations sometimes produce research reports under a single global brand name or jointly with a research analyst employed by a non-member affiliate—*i.e.*, a “mixed team” research report. NASD and NYSE have deemed such research reports to be attributable to the member and therefore subject to the applicable requirements of Rule 2711. This interpretation has raised the question of whether a research analyst employed by a non-member foreign affiliate who contributes to the preparation of such a research report (foreign research analyst) must meet the licensing and examination requirements set forth in Rule 1050. The determination turns on whether the foreign research analyst is an “associated person” of the NASD member.

Several members have expressed to NASD and NYSE that the determination of “associated person” status can be very difficult to ascertain in a financial services enterprise that has a complex structure of supervision and multiple reporting lines and subsidiaries and/or affiliated firms that span a multitude of foreign jurisdictions. While NASD does not subscribe to the viewpoint that the difficulty of the associated person analysis relieves a member from making the determination of such status, it is

concerned that absent the safe harbor provided in this proposal, members may have a pragmatic incentive, although not a defensible basis, for construing associated person status on an unduly narrow basis.

Therefore, to help alleviate these issues while maintaining—and in some cases, extending—the safeguards in Rules 1050 and 2711 that ensure objective and quality research, the SROs have created an exemption from the research analyst qualification requirements for certain foreign research analysts in jurisdictions that reflect a recognition of the principles that are consonant with the SRO qualification standards and research analyst conflict of interest rules.

The conditions for eligibility for the exemption are as follows:

1. Compliance by the foreign research analyst with registration and qualification requirements or other standards in his or her home jurisdiction that have been designated by the SROs as having acceptable qualification standards and research analyst conflict of interest rules. Based on a review of their regulatory and qualification requirements, the SROs have identified the following jurisdictions as having met the applicable standard: the United Kingdom, China, Hong Kong, Singapore, Thailand, Malaysia, and Japan. NASD will notify the membership in the event that additional jurisdictions are deemed to have met the standard.

Foreign research analysts that have met such requirements in an approved jurisdiction will not be required to pass the Series 86 and 87 exams, provided the member and foreign research analyst comply with the other requirements set forth as conditions for the exemption. Research analysts in jurisdictions that do not have approved standards still would be required to pass the Series 86 and 87 examinations if they are associated persons and participate in the preparation of a member's research report.

2. Global application of member firm standards, including full compliance with the SRO research analyst conflict of interest rules, to a member's affiliated entities and foreign research analysts that qualify for the use of, and would rely upon, these exemptive provisions. Thus, a member would be required to apply to any globally branded, mixed-team, or other research deemed under SRO rules and interpretations to be that of the member, all of the applicable provisions of the SRO rules, as well as any other regulatory or supervisory standards applicable to a member's own research. The personal trading restrictions and other SRO rules applicable to the conduct of a research analyst need only be applied to the specific research reports to which a foreign research analyst contributed in the preparation. These conditions do not apply to research reports that are wholly produced by a foreign affiliate and its employees and are clearly labeled as the product of that foreign affiliate.
3. The annual compliance attestation required by NASD Rule 2711 must encompass the global application of the SRO rules to foreign affiliates that participate in preparing a member's research reports.

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4. Members must agree to have their research approved by a properly registered supervisory analyst or principal in accordance with NASD Rule 1022.
 5. In addition to the disclosure requirements of NASD Rule 2711, each report must include, when applicable, a disclosure on the front cover stating that:

“This research report has been prepared in whole or part by foreign research analysts who may be associated persons of the member or member organization. These research analysts are not registered/qualified as research analysts with the NYSE and/or NASD, but instead have satisfied the registration/qualification requirements or other research-related standards of a foreign jurisdiction that have been recognized for these purposes by the NYSE and NASD.”

In addition, the cover page of a research report must identify: (1) each broker-dealer entity contributing to the report, (2) its location, and (3) the research analysts contributing to the research report from each broker-dealer. The cover page must also contain general disclosure language regarding the relationship of the listed broker-dealers to the NYSE/NASD member firm.

The front page of the research report must reference a separate “Foreign Affiliate Disclosures” section (similar to the “Required Disclosure” section currently mandated by the SROs) located in close proximity to that section. In this proposed disclosure section, the member must disclose the following: (1) information on the nature of the affiliation of the parties, (2) the affiliates’ addresses, and (3) the primary regulator in the jurisdiction(s) in which each affiliate is located.

Eligibility for the exemption in no way bears upon whether the foreign research analyst is an associated person of the member. And to the extent that a member can determine that a foreign research analyst is not an associated person, those individuals need not satisfy the requirements of the exemption.

Members must establish and maintain records that identify those individuals who have availed themselves of the exemption, the basis for such exemption, and evidence compliance with the conditions of the exemption.

The rule change has no impact on the obligation of a broker-dealer, including a foreign broker-dealer, to register pursuant to Section 15(a)(1) of the Securities Exchange Act of 1934 and the rules promulgated thereunder.

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