

## SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-51644; File Nos. SR-NYSE-2005-25; SR-NASD-2005-043)

May 2, 2005

### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Changes by the New York Stock Exchange, Inc. and the National Association of Securities Dealers, Inc. Relating to an Exemption from the Research Analyst Qualification Examination for Certain Associated Persons Employed by Non-Member Foreign Affiliates Who Contribute to the Preparation of Member Research Reports**

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or the “Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 1, 2005, the New York Stock Exchange, Inc. (“NYSE” or the “Exchange”) and the National Association of Securities Dealers, Inc. (“NASD”), filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule changes as described in Items I and II below, which Items have been prepared by the respective self-regulatory organizations.<sup>3</sup> The NYSE and NASD (the “SROs”) have each filed the proposed rule changes as constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule pursuant to Section 19(b)(3)(A) of the Act<sup>4</sup> and Rule 19b-4(f)(1) thereunder,<sup>5</sup> which renders the proposed rule changes effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule changes from interested persons.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> On May 2, 2005, the NYSE filed with the Commission Amendment No. 1 to its proposed rule change which made technical corrections to the proposed rule text of the proposed rule change.

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>5</sup> 17 CFR 240.19b-4(f)(1).

**I. Self-Regulatory Organizations' Statements of the Terms of Substance of the Proposed Rule Changes**

The NYSE is filing with the Commission a proposed interpretation to NYSE Rule 344 to establish an exemption from the Research Analyst Qualification Examination Requirements for Certain Foreign Research Analysts.

Pursuant to the provisions of Section 19(b)(3) of the Act,<sup>6</sup> the NASD is filing with the Commission a proposed rule change to amend NASD Rule 1050 to create an exemption from the Research Analyst Qualification Examination (Series 86 and 87) for certain research analysts employed by foreign affiliates of a member who contribute to the preparation of a member's research reports. The proposed rule change also makes one non-substantive change to NASD Rule 1050 to correct a spelling error.

Below is the text of the proposed rule changes. Brackets indicate deletions; italics indicate additions.

**A. NYSE's Proposed Rule Text**

**Interpretation**

**Rule 344 RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS**

**/01 Research Analysts (No Change)**

**/02 Foreign Research Analysts**

**Exemption**

The requirement that a research analyst as defined under NYSE Rule 344.10 must be registered with, qualified by and approved by the Exchange shall not apply where such analyst is an associated person of a member or member organization who is an employee of a non-member

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<sup>6</sup> 15 U.S.C. 78s(b)(3).

foreign affiliate of such member or member organization who contributes to the preparation of the member's or member organization's research reports ("foreign research analyst"), provided the following conditions are satisfied:

- The foreign research analyst resides and is employed in a jurisdiction that the NYSE has determined has registration and qualification requirements or other standards that reflect a recognition of principles that are consonant with NYSE Rule 344 and the research analyst conflicts of interest provisions pursuant to NYSE Rule 472;
- The foreign research analyst has satisfied all applicable registration and qualification requirements or other research-related standards in the jurisdictions in which the foreign research analyst resides and is employed;
- Members and member organizations have imposed on affiliates that employ foreign research analysts, and the foreign research analysts all research-related standards that the member or member organization imposes on its research reports and research analysts, including the provisions of NYSE Rule 472;
- Members, member organizations and their affiliates that distribute research reports partially or entirely prepared by a foreign research analyst must subject such research reports to pre-use review and approval by a supervisory analyst, as required by NYSE Rule 472;

- The annual attestation required under NYSE Rule 351(f) must include the global application of NYSE Rule 472 to foreign affiliates that employ foreign research analysts;
- In addition to the disclosure requirements of NYSE Rule 472, each research report must include a disclosure on the front page 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 a research analyst 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.”

Disclosure on the front page of each research report must identify:

- (1) each affiliate contributing to the research report;
- (2) the location of such affiliate; and
- (3) the names of the foreign research analysts employed by each contributing affiliate.

The cover page must also contain general disclosure language describing the relationship between the contributing affiliates and the member or member organization.

The front page of the research report must also refer to a separate “Foreign Affiliate Disclosures” section (similar to the “Required Disclosure” section currently mandated by the NYSE and NASD under Rules 472 and 2711 respectively) located in close proximity to the “Required Disclosure” section.

In this disclosure section, the member or member organization must disclose the following:

- (1) information on the nature of the affiliation with the affiliate;
- (2) each affiliate’s address; and
- (3) the primary regulator in the jurisdiction(s) in which each affiliate is located.

### **Record Keeping**

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

**[/02]/03**

### **Supervisory Analysts**

#### **Qualifications**

Supervisory Analyst candidates shall qualify by taking and passing the Supervisory Analyst (Series 16) Examination.

#### **Experience**

Appropriate experience for a candidate for Supervisory Analyst means having at least three years prior experience within the immediately preceding six years involving securities or financial analysis.

Examples of appropriate experience may include the following:

- Equity or Fixed Income Research Analyst;
- Credit Analyst for a securities rating agency;
- Supervising preparation of materials prepared by financial/securities analysts;
- Financial analytical experience gained at banks, insurance companies or other financial institutions;
- Academic experience relating to the financial/securities markets/industry.

### **Director of Research**

A person having the title of “Director of Research” need not be a supervisory analyst as defined by the Rule so long as he/she does not approve research reports. If, however, such a person is in charge of registered representatives, he/she must qualify as a supervisory person under Rule 342.13.

### **Exemptions**

Successful completion of the CFA Level I Examination administered by the CFA Institute (in lieu of completion of Levels, I, II and III for a full CFA designation) will suffice to allow a Supervisory Analyst candidate to qualify by taking Part I of the Series 16 Qualification Examination.

## **B. NASD's Proposed Rule Text**

### **1050. Registration of Research Analysts**

(a) through (b) No change.

(c) Upon written request pursuant to the Rule 9600 Series, NASD will grant a waiver from the analytical portion of the Research Analyst Qualification Examination (Series 86) upon verification that the applicant has passed:

(1) Levels I and II of the Chartered Financial Analyst ("CFA")

Examination; or

(2) through (3) No change.

(d) through (e) No change

(f) The requirements of paragraph (a) shall not apply to an associated person who is an employee of a non-member foreign affiliate who contributes to the preparation of a member's research report ("foreign research analyst"), provided the following conditions are met:

(1) the foreign research analyst resides and is employed in a jurisdiction that NASD has determined has registration and qualification requirements or other standards that reflect a recognition of principles that are consonant with this rule and the research analyst conflict of interest rules pursuant to Rule 2711;

(2) the foreign research analyst has satisfied all applicable registration and qualification requirements or other research-related standards in the jurisdiction in which the foreign research analyst resides and is employed;

(3) the NASD member ("U.S. member") whose research reports a foreign research analyst contributes in the preparation of has imposed on its affiliates and

the foreign research analysts they employ all of the provisions of Rule 2711 and all other research-related standards the member imposes on its own research reports and research analysts;

(4) the annual compliance attestation submitted by the U.S. member pursuant to Rule 2711(i) must encompass the global application of Rule 2711 to the U.S. member's foreign affiliates that participate in the preparation of the U.S. member's research reports;

(5) all U.S. member research reports to which a foreign research analyst contributes in the preparation must be approved by a properly registered principal or supervisory analyst pursuant to Rule 1022; and

(6) in addition to the disclosure requirements of Rule 2711, each U.S. member research report to which a foreign research analyst contributes in the preparation shall include the following on the front page:

(A) a statement 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 a research analyst 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.”

(B) disclosures identifying each affiliate contributing to the research report, the location of such affiliate, and the names of the research analysts employed by the affiliate that contributed to the preparation of the research report;

(C) a general description of the relationship between the contributing affiliates and the U.S. member; and

(D) a reference to the page on which a separate “Foreign Affiliate Disclosures” section can be found. Such section shall disclose information on the nature of the affiliation between the entities, the affiliates’ addresses, and the primary regulator in the jurisdiction(s) in which each affiliated entity is located.

(7) Members must establish and maintain records that identify those individuals who have availed themselves of the exemption in paragraph (f), specify the basis for such exemption, and evidence compliance with the conditions of paragraph (f).

## **II. Self-Regulatory Organizations’ Statements of the Purpose of, and Statutory Basis for, the Proposed Rule Changes**

In their filings with the Commission, the NYSE and NASD included statements concerning the purpose of and basis for the proposed rule changes and discussed any comments they received on the proposed rule changes. The text of these statements may be examined at the places specified in Item IV below. The NYSE and NASD have

prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

**A. Self-Regulatory Organizations’ Statements of the Purpose of, and Statutory Basis for, the Proposed Rule Changes**

(1) NYSE’s Purpose

Recent amendments to NYSE Rule 344 (“Research Analysts and Supervisory Analysts”) require “research analysts” to be registered with, qualified by, and approved by the Exchange. The Exchange is proposing to adopt a new interpretation to NYSE Rule 344 to exempt certain foreign research analysts employed by a non-member affiliate of a member or member organization from the Research Analyst Qualification Examination (Series 86/87).

Background

Recent amendments to NYSE Rule 344 require that research analysts be registered and qualified by the NYSE.<sup>7</sup> According to the NYSE, the Research Analyst Qualification Examination is part of the SRO’s regulatory efforts to safeguard the investing public from potential conflicts of interest relating to research analysts. The NYSE believes that the purpose of requiring a qualification examination is to protect the investing public by helping to ensure that research analysts are competent to perform their jobs and are knowledgeable about the new regulatory requirements affecting them. Given the scope and magnitude of these requirements, the SROs developed an examination with a part designed specifically to address the new SRO rule requirements.

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<sup>7</sup> According to the NYSE, the amendments were the culmination of joint regulatory efforts among the SROs and the SEC to address potential conflicts of interest relating to research analysts. The amendments included, among other things, a new registration category and qualification examination for research analysts.

The Research Analyst Qualification Examination (Series 86/87) is a five-and-a-half hour examination, consisting of 150 questions. The exam is divided into two parts. Part I, the Series 86, consists of 100 questions, which address fundamental security analysis and valuation of equity securities. Part II, the Series 87, consists of 50 questions, which primarily address pertinent SRO and SEC rules and regulations, including the recent Research Analysts' Conflicts Rules.

The requirement to take and pass the Series 86/87 examination applies to all research analysts, as defined in Exchange Rule 344.10, which provides that the term "research analyst" includes a member, allied member, associated person or employee who is primarily responsible for the preparation of the substance of a research report and/or whose name appears on such report.<sup>8</sup> Research analysts, must be registered with, qualified and approved by the Exchange. The registration and qualification requirement became effective March 30, 2004. Candidates who have been functioning as research analysts as of the effective date of March 30, 2004, and submitted a registration application by June 1, 2004, have been given until April 4, 2005 to meet the qualification requirements.

#### Prerequisites to and Exemptions from the Qualification Examination

In March 2004, the SEC approved an interpretation to Exchange Rule 344 establishing certain prerequisites to and exemptions from the Research Analyst Qualification Examination.<sup>9</sup> The interpretation to NYSE Rule 344 requires, among other

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<sup>8</sup> See SR-NYSE-2005-24 amending the definition of "research analyst" in NYSE Rules 344.10 and 472.40 to include "associated persons."

<sup>9</sup> See Securities Exchange Act Release No. 49464 (March 24, 2004), 69 FR 16628 (March 30, 2004) (SR-NYSE-2004-03).

things, that each candidate pass the General Securities Registered Representative Examination (Series 7) prior to taking either Part I or Part II of the examination. The interpretation to Exchange Rule 344 also allows a research analyst candidate who has passed both Level I and Level II of the Chartered Financial Analyst (“CFA”) Examination administered by the CFA Institute to request an exemption from Part I (Series 86) of the Research Analyst Qualification Examination.<sup>10</sup>

#### Application of Examination Requirement to Foreign Research Analysts

In March 2004, the NYSE and NASD issued a Joint Memo providing guidance on research analyst issues. In that memo, the SROs stated that all of the SRO rule requirements would apply to any research report to whose preparation a research analyst employed or associated with a member or member organization contributed (e.g., “globally-branded” and “mixed research team”<sup>11</sup> research reports, whether or not issued by a member or member organization).

In April 2004, the Exchange issued an Information Memo announcing the approval of the examination requirements noted above and discussing examination-

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<sup>10</sup> In February 2005, the SEC provided public notice of a similar alternative qualification standard for the Series 86 examination requirement for research analysts who prepare only technical research reports and who have passed Levels I and II of the Chartered Market Technician (“CMT”) Program administered by the Market Technicians Association (“MTA”). See Securities Exchange Act Release No. 51240 (February 23, 2005), 70 FR 10451 (March 3, 2005) (SR-NYSE-2005-12).

<sup>11</sup> A “globally-branded” research report refers to the use of a single marketing identity that encompasses the member firm and its affiliates. A research report prepared by a “mixed research team” which includes at least one person who meets the definition of “research analyst” and is associated with a member or member organization would be considered a report prepared by the member or member organization. See NYSE Information Memo 04-10, dated March 9, 2004.

related requirements.<sup>12</sup>

In June 2004, the SROs received a written submission from Goldman Sachs & Co. (“Goldman”) requesting relief under NASD Rule 1050 and NYSE Rule 344 for equity research analysts employed by its foreign broker-dealer affiliates, and seeking further clarification as to whether research analysts employed by a foreign broker-dealer should appropriately be deemed “associated persons” of the NASD/NYSE member firms in the context of global businesses.<sup>13</sup> In its submission, Goldman requested that U.S. regulators should consider the impact that such views could have on many firms’ businesses, including possible licensing consequences on the U.S. broker-dealers in such foreign jurisdictions, and other issues of international comity.

In July 2004, the Exchange received a written submission from Smith Barney Citigroup (“Smith Barney”) requesting clarification with respect to treatment of research analyst employees of foreign broker-dealer affiliates.<sup>14</sup> Citing the SROs’ memos, Smith Barney advised that there were widely divergent approaches and practices developing as a result of the interpretive guidance. In this regard, some firms had begun the process of having foreign research analysts prepare for the examination, while other firms, contrary to the express language in the interpretation, were applying the examination requirements only to U.S. research analysts. In its submission, Smith Barney requested further

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<sup>12</sup> See NYSE Information Memo 04-16, dated April 1, 2004. In these memos, the SROs advised that research analysts employed by foreign broker-dealer affiliates of a member or member organization are subject to the Series 86/87 examination to the extent that the research analyst is an “associated person” of the member or member organization.

<sup>13</sup> Letter dated June 1, 2004 from Pamela Root and John Curtis of Goldman to the Exchange and NASD.

<sup>14</sup> Letter dated July 23, 2004 from Michael Sharp of Smith Barney to Richard G. Ketchum, Chief Regulatory Officer of the NYSE.

clarification of the interpretive guidance to facilitate consistent application by member organizations.

Smith Barney also requested that the SROs adopt a different approach, proposing that they recognize non-U.S. research analysts who (a) are properly registered and licensed to conduct securities business in their country of residence and (b) are subject to policies that are substantively identical to the SRO rules, could publish research in the U.S. under a global-research trademark without having to be licensed in the U.S. The term “substantively identical” was defined to include clearance of all research by a Series 16 supervisory analyst and supervision by a Series 24 principal. Under the requested relief, a non-U.S. research analyst would not have to take either the Series 7 prerequisite or the Series 86/87 examination.

According to the NYSE, in subsequent meetings and conference calls with member firms, they expressed their concern 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.

On February 25, 2005, the SROs received a written submission from an industry committee<sup>15</sup> requesting SRO interpretive guidance to establish a safe harbor pursuant to which non-U.S. research analysts that are associated with U.S. member firms would be permitted to disseminate research in the U.S., notwithstanding the fact that such research analysts have not taken the Series 86/87 examination. According to the NYSE, the

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<sup>15</sup> The signatories to the submission were representatives from Goldman, Morgan Stanley and Smith Barney.

proposed relief sought by the industry committee, and the conditions thereto, are substantially similar to the relief the SROs are implementing in this filing.<sup>16</sup>

According to the NYSE, in seeking this relief, the industry advised that the safe harbor was appropriate and reasonable for the following reasons: (1) it respects the primacy of the laws of other jurisdictions by avoiding circumstances under which research analysts could become subject to multiple licensing requirements and taking multiple exams in many different countries; (2) it makes clear that non-U.S. research analysts associated with a member firm are held to the principles enumerated in the SRO rules; and (3) U.S. investors would have sufficient notice through the disclosure to the effect that non-U.S. research analysts associated with a member firm are not subject to the SROs' registration and qualification standards.

According to the NYSE, while the SROs do not agree that the difficulty of the associated person analysis relieves a member firm from making the determination of such status, the SROs are concerned that, absent the safe harbor provided in this proposal, members and member organizations may have a pragmatic incentive, although not a defensible basis, for construing associated person status on an unduly narrow basis.

According to the NYSE, in order to address these issues while maintaining – and in fact, extending – the safeguards in the SRO rules that ensure objective and quality research, the SROs are proposing an exemption from the research analyst qualification requirements for certain analysts employed by foreign entities in jurisdictions that reflect a recognition of the principles that are consonant with the SRO qualification standards and research analyst conflict of interest rules.

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<sup>16</sup> In addition, Commission staff received a copy of this submission with supporting documentation.

According to the NYSE, the proposed exemption would, where appropriate, address: (1) the requirement that foreign research analysts, when they are “associated persons,” to register and qualify as research analysts under the SRO rules; (2) the applicability of the SRO rules with respect to research reports where foreign research analysts have contributed to the preparation; and (3) provide additional disclosure requirements related to such research reports, including but not limited to, globally branded and mixed research team reports.

#### Proposed Exemptive Relief

The NYSE and NASD are proposing to exempt from the Series 86 and 87 examination requirements certain research analysts employed by foreign affiliates who contribute to the preparation of a member or member organization’s research reports.<sup>17</sup>

The SROs would recognize as the basis for exemptive relief from the Series 86 and 87 exams registration/qualification requirements, compliance with other standards in non-US jurisdictions that reflect recognition of the principles that are consonant with the SRO qualification standards and the research analyst conflict of interest rules.<sup>18</sup> The SROs will identify the jurisdictions that satisfy the prescribed criteria.

According to the NYSE, such principles generally would include a combination of: (1) rules that govern research analysts and firm conflicts of interest in the preparation and distribution of research reports; (2) a requirement that research analysts be registered

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<sup>17</sup> The proposed rule change would have no impact on the obligation of any 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.

<sup>18</sup> Eligibility for the exemption contemplated by this proposed rule change in no way bears upon whether the foreign research analyst is an “associated person” of the member or member organization. To the extent that a member or member organization can determine that a foreign research analyst is *not* an “associated person,” those individuals need not satisfy the requirements of the rule or the exemption.

or licensed by a regulatory authority: or (3) a testing or experience requirement that demonstrates research analysts' skills and/or knowledge of rules and regulations applicable to research analysts and their firms in the preparation and distribution of research reports.

Foreign research analysts who participate in preparing a member firm's research reports, including but not limited to globally-branded and/or mixed research team reports, and have met applicable requirements in a jurisdiction with approved standards, will not be required to pass the Series 86 and 87 exams, provided the member or member organization complies with the other requirements set forth herein.<sup>19</sup>

1. The SROs would require global application of a member firm's own standards, including full compliance with the SRO research analyst conflict of interest rules, to a member's or member organization's affiliated entities and foreign research analysts that qualify for the use of, and who will rely upon, these exemptive provisions. Thus, a member or member organization would be required to subject any globally-branded, mixed-team or other research deemed under the SRO rules and interpretations to be that of the member or member organization, to all of the applicable provisions of the SRO rules as well as any other regulatory or supervisory standards applicable to a member's or member organization's research. Thus, the research provisions of NYSE Rule 472, e.g., personal trading restrictions, would be applied to the specific research

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<sup>19</sup> Foreign research analysts in jurisdictions that do not have approved standards would still be required to pass the Series 86 and 87 examinations if they are "associated persons" and participate in the preparation of a member's or member organization's research report.

reports and the particular foreign research analysts that contributed to the preparation of a member's or member organization's research report. The conditions of this paragraph shall not apply to research reports that are wholly produced by a foreign affiliate and its employee and are clearly labeled as the product of that foreign affiliate.<sup>20</sup>

2. The annual compliance attestation required by NYSE Rules 472 and 351 would encompass the global application of the SRO rules to foreign affiliates that participate in preparing a member's or member organization's research report.
3. Members' and member organizations' research reports must be approved by a properly registered supervisory analyst/principal.<sup>21</sup>
4. In addition to the disclosure requirements of NYSE Rule 472, each report would include 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 front page of a research report must identify:

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<sup>20</sup> See Information Memo Nos. 02-26 (June 26, 2002) and 04-10 (March 9, 2004) for a member's or member organization's disclosure requirements when distributing third party research of an affiliate or non-affiliate.

<sup>21</sup> NYSE Series 16.

- (1) each affiliate contributing to the research report;
- (2) the location of such affiliate; and
- (3) the names of the research analysts contributing to the report employed by each affiliate.

The front page would also contain general disclosure language describing the relationship of the contributing affiliates to the NYSE/NASD member firm.

The front page of the research report would also refer to a separate “Foreign Affiliate Disclosures” section (similar to the “Required Disclosure” section currently mandated by the SROs) located in close proximity to the Required Disclosure section.

In this disclosure section, the member or member organization would 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.

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

As of the date of this filing, the SROs have identified the following jurisdictions that have satisfied the applicable standards noted above:<sup>22</sup>

- (1) China

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<sup>22</sup> The Exchange will announce these jurisdictions in an Information Memo and will issue subsequent Information Memos to update the list of the approved jurisdictions, as needed.

- (2) Hong Kong
- (3) Japan
- (4) Malaysia
- (5) Singapore
- (6) Thailand
- (7) United Kingdom.

A review of jurisdictions named above revealed that they had in place registration/qualification requirements for research analysts and/or imposed conflict of interest disclosure requirements, and/or restrictions on research analysts' trading that were acceptable to the SROs. Accordingly, the proposed amendment seeks an exemption for foreign research analysts employed in these jurisdictions from the Research Analyst Qualification Examination requirement.

(2) NYSE's Statutory Basis

The statutory basis for this proposed rule change is Section 6(b)(5)<sup>23</sup> and Section 6(c)(3)(B)<sup>24</sup> of the Exchange Act. Under Section 6(b)(5), the rules of the Exchange must be designed to protect investors and the public interest. The Exchange believes that the proposed rule change is consistent with Section 6(b)(5) in that it will ensure that those research analysts contributing to the preparation of a member's or member organization's research reports are subject to a regulatory scheme that advances objective and unbiased research thereby enhancing investors protection.

Under Section 6(c)(3)(B), it is the Exchange's responsibility to prescribe standards of training, experience and competence for persons associated with Exchange

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<sup>23</sup> 15 U.S.C. 78f(b)(5).

<sup>24</sup> 15 U.S.C. 78f(c)(3)(B).

members and member organizations. In addition, the Exchange may bar a natural person from becoming a member or person associated with a member, if such natural person does not meet such standards of training, experience and competence as prescribed by the rules of the Exchange. Pursuant to this statutory obligation, the Exchange has developed a competency qualification examination for research analysts and is providing relief from this requirement where foreign research analysts and their member firms have demonstrated registration, qualification, and conflict of interest standards acceptable to the Exchange.

(3) NASD's Purpose

NASD Rule 1050 requires an associated person who functions as a research analyst to register as such with NASD and pass a qualification examination. According to NASD, NASD 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, NASD 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 NASD Rule 1050 has the meaning as defined in NASD 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 NASD 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.

NASD 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 NASD 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 NASD 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 or whose name appears on such report must meet the licensing and examination requirements set forth in NASD Rule 1050. According to NASD, the determination turns on whether the research analyst employed by the foreign affiliate is an “associated person” of the NASD member.

According to NASD, 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.

According to NASD, in order to help alleviate these issues while maintaining – and in some cases, extending – the safeguards in NASD Rules 1050 and 2711 that ensure objective and quality research, NASD and the NYSE are proposing an exemption from the research analyst qualification requirements for certain analysts employed by member foreign affiliates 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 proposed exemption are as follows:

1. The SROs would recognize as the basis for exemptive relief from the Series 86 and 87 examinations compliance with registration and qualification requirements or other standards in foreign jurisdictions that reflect a recognition of the principles that are consonant with the SRO qualification standards and the research analyst conflict of interest rules. According to NASD, such principles generally will include a combination of (1) rules that govern analyst and firm conflicts of interest in the preparation and distribution of research, (2) a requirement that analysts be registered or licensed by a regulatory authority, or (3) a testing or experience requirement that demonstrates analyst skills and/or knowledge of rules and regulations applicable to analysts and their firms in the preparation and distribution of research.

Foreign analysts who participate in preparing a member's research reports and have met such requirements in an approved jurisdiction will not be required to pass the Series 86 and 87 exams, provided the member complies with the other requirements set forth as conditions for the exemption. 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. The SROs would require 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 in which a foreign research analyst contributed to the preparation. None of the conditions of this paragraph shall 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 would encompass the global application of the SRO rules to foreign affiliates that participate in preparing a member's research reports.

4. Members must agree to have their research approved by a properly registered supervisory analyst or principal in accordance with NASD Rule 1022; and

5. In addition to the disclosure requirements of NASD Rule 2711, each report would need to 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 a research analyst 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 would 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 would need to reference to 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 would be required to 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 contemplated by this proposed rule change 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.

NASD will identify in a Notice to Members those jurisdictions that, based on a review of their regulatory and qualification requirements, meet the standard set forth above and shall issue subsequent Notices to Members to update the list of approved jurisdictions, as need.<sup>25</sup>

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 proposed rule change would have no impact on the obligation of a broker-dealer, including a foreign broker-dealer, to register pursuant to Section 15(a)(1) of the Exchange Act<sup>26</sup> and the rules promulgated thereunder.

The proposed rule change also makes one non-substantive change to NASD Rule 1050 to correct a spelling error.

#### (4) NASD's Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>27</sup> which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that that the proposed rule change is consistent with the

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<sup>25</sup> As of the date of this filing, the SROs have identified the following jurisdictions as having met the applicable standard: the United Kingdom, China, Hong Kong, Singapore, Thailand, Malaysia and Japan.

<sup>26</sup> 15 U.S.C. 78q(a)(1).

<sup>27</sup> 15 U.S.C. 78q-3(b)(6).

provisions of the Act noted above in that it will ensure that those individuals contributing to the preparation of a member's research reports are subject to a regulatory scheme that advances objective and quality research, thereby enhancing investor protection.

**B. Self-Regulatory Organizations' Statements on Burden on Competition**

The NYSE and NASD do not believe that the proposed rule changes will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

**C. Self-Regulatory Organizations' Statements on Comments on the Proposed Rule Changes Received from Members, Participants, or Others**

The NYSE and NASD have neither solicited nor received written comments.

**III. Date of Effectiveness of the Proposed Rule Changes and Timing for Commission Action**

The foregoing rule changes have become effective pursuant to Section 19(b)(3)(A) of the Act<sup>28</sup> and paragraph (f)(1) of Rule 19b-4 thereunder,<sup>29</sup> in that the proposed rule changes constitute a stated policy, practice or interpretation with respect to the meaning, administration, or enforcement of an existing rule. At any time within 60 days of the filing of the proposed rule changes, the Commission may summarily abrogate such rule changes if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

**IV. Solicitation of Comments**

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<sup>28</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>29</sup> 17 CFR 240.19b4-4(f)(1).

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule changes are consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Numbers SR-NYSE-2005-25 and/or SR-NASD-2005-043 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Numbers SR-NYSE-2005-25 and/or SR-NASD-2005-043. These file numbers should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule changes that are filed with the Commission, and all written communications relating to the proposed rule changes between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection

and copying at the principal offices of the NYSE and NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to the File Numbers SR-NYSE-2005-25 and/or SR-NASD-2005-043 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>30</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>30</sup> 17 CFR 200.30-3(a)(12).