

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49857; File No. SR-NASD-2004-078)

June 15, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. to Establish Certain Qualification Requirements for Supervisors of Research Analysts

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 10, 2004, the National Association of Securities Dealers, Inc. (“NASD”), filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change**

NASD is proposing a rule change to amend NASD Rule 1022 to establish certain qualification requirements for supervisors of research analysts. More specifically, the proposed rule change would require supervisors of research analysts to pass the regulatory part (Series 87) of the Research Analyst Qualification Examination or the Series 16 Supervisory Analyst Examination administered by the New York Stock Exchange (“NYSE”).

Below is the text of the proposed rule change. Proposed new language is in italics.

**1022. Categories of Principal Registration**

**(a) General Securities Principal**

(1) through (4) No change.

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

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

(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.

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**II. Self-Regulatory Organization’s Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

New NASD Rule 1050, which became effective on March 30, 2004, requires all persons associated with a member who are to function as research analysts to be registered as such with NASD and pass a qualification examination.<sup>3</sup> Those individuals required to be registered as

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<sup>3</sup> For the purposes of this registration 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.” To be consistent with Rule 2711, Research Analysts And Research Reports, the registration requirement applies only to equity research analysts; fixed income analysts do not need to be registered as research analysts at this time.

research analysts must pass the new Research Analyst Qualification Examination (Series 86/87) or qualify for an exemption. NASD and the NYSE jointly developed the new examination, which consists of two parts: an analysis part (Series 86) that tests fundamental analysis and valuation of equity securities and a regulatory part (Series 87) that tests knowledge of applicable rules, including Rule 2711, NYSE Rule 344 and SEC Regulation AC.

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). Individuals who have passed Level II of the Charter Financial Analyst Examination administered by the Association for Investment Management and Research can apply for an exemption from the Series 86. Those persons who were functioning as research analysts on the effective date have been granted a one-year grace period within which to meet the registration requirements. There is no “grandfather” provision for this new qualification requirement.

In light of the new research analyst registration requirement and the scope and importance of the comprehensive analyst conflict rules that have been implemented recently, NASD believes it appropriate for supervisors of research analysts to have particular knowledge of this new regulatory environment. Accordingly, NASD is proposing to amend Rule 1022 to require supervisors of research analysts to pass the regulatory part (Series 87) of the Research Analyst Qualification Examination or, for dual NASD-NYSE members, the NYSE Supervisory Analyst Examination (Series 16).

For dual members, NASD currently permits either a Series 16 supervisory analyst or a Series 24 General Securities Principal to supervise 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). NASD requires a Series 24 General Securities Principal to supervise all other conduct of an individual who functions as a research analyst. For NASD-only members, a Series 24 General Securities Principal currently is required to supervise both the content of research reports and research analysts.

Under the proposed rule change, dual members would be required to have a principal who has passed either the Series 24 and the Series 87 or the Series 16 to supervise the content of research. If the member elects to have a Series 16 be responsible for supervising the content of research, then a Series 24 principal who has also passed either the Series 87 or the Series 16 would be responsible for supervising the conduct of both the Series 16 supervisory analyst and the research analyst.<sup>4</sup> This proposed rule change would provide dual members some flexibility in their supervisory structure for research analysts. NASD-only members would be required to have a principal who has passed the Series 24 and the Series 87 supervise both the content of research reports and the conduct of registered research analysts.

NASD believes that this approach will promote investor protection by ensuring that persons responsible for either reviewing and 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

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<sup>4</sup> NYSE has represented to NASD that it will conform the Series 16 examination to include applicable NASD rules by December 31, 2004. Based on that representation, NASD has agreed to recognize the Series 16 in lieu of the Series 87 until at least year-end, at which point NASD will reassess the applicability of the Series 16 for NASD members.

proposal would preserve the longstanding NASD requirement that a General Securities Principal be responsible for the general conduct of a registered person.

NASD does not anticipate providing a “grandfather” provision for current supervisors of research analysts. However, NASD would provide a reasonable amount of time for those supervisors to meet the requirements of the proposed rule changes, so as not to disrupt a member’s research business.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6)<sup>5</sup> of the Act, 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 the proposed rule change is consistent with the provisions of the Act because it will better protect investors by ensuring that those who supervise research analysts demonstrate particularized knowledge of the research analyst conflict of interest laws, rules and regulations.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change 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 Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

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<sup>5</sup> 15 U.S.C. 78o-3(b)(6).

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is 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 Number SR-NASD-2004-078 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 No. SR- NASD-2004-078. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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 change that are filed with the Commission, and all written communications relating to the proposed rule change 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. Copies of such filing will also be available for inspection and copying at the principal office of NASD. All submissions should refer to file number SR- NASD-2004-078 and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>6</sup> 17 CFR 200.30-3(a)(12).