Corporate Securities

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Investment Dealers Association of Canada Proposes Revised Policy on Analyst Standards

Background

As public scrutiny continues to focus on potential conflicts of interest affecting research analysts, the Investment Dealers Association of Canada ("IDA") has published a revised version of its proposed Policy No. 11 - Analyst Standards. Proposed Policy No. 11, which is intended to improve investor confidence by setting higher practice standards for analysts, has been revised by:

- increasing disclosure requirements for research reports,
- recasting numerous quasi-voluntary "guidelines" as mandatory "standards", and
- providing greater harmonization with the standards of its U.S. counterpart, Rule 2711 of the National Association of Securities Dealers ("NASD 2711"), although important differences remain.

This update summarizes the significant amendments in revised Policy No. 11 and also includes a discussion of another recent IDA initiative designed to increase harmonization with the U.S. model. Policy No. 11 is currently under consideration by the Ontario Securities Commission. Although not yet effective, the IDA has indicated that compliance by dealers is expected during the interim period prior to approval by the Commission.

Revised Policy No. 11

- ***Written Policies:*** All conflict of interest policies and procedures must be submitted to the IDA in writing, including policies (with prescribed minimum requirements) to prevent research reports from being influenced by the investment banking department of the dealer or by the subject issuer.
- ***No Boilerplate:*** All disclosure must be clear, comprehensive and prominent. Boilerplate is specifically identified as unacceptable.
- ***Broad Standard of Disclosure:*** The general disclosure standard remains intentionally broad. For example, disclosure would be required where an affiliate of a dealer is a lender to an issuer and there is a failure by the issuer to pay on indebtedness that is material to the dealer.
- ***Restrictions re Associates:*** A report may not be issued if the analyst who prepared the report or an associate of the analyst is an officer, director, employee or advisor of the issuer.
- ***Reduced Disclosure Time Frames:*** The requirement for disclosure of prior remunerative investment banking relationships between the dealer and the issuer has been reduced from 24 to 12 months (making it consistent with the requirement in NASD 2711).
- ***Market Makers:*** Disclosure is now required if the dealer is making a market in the security of the issuer.
- ***Blackout Periods and Quiet Periods:*** An analyst or anyone involved in the preparation of a report may not trade securities of an issuer (including derivatives) for 30 days before and five days after publication of the research report, unless specified written internal approval is received. Furthermore, no report may be issued

regarding an issuer for 40 days after an initial public offering or ten days after a secondary offering where the dealer acted as a manager or a co-manager. These requirements are now more consistent with NASD 2711.

- ***Compendium Reports:*** A report that covers six or more issuers may indicate where the relevant disclosure can be found (e.g., the dealer's website), rather than including the disclosure in the report itself, again resulting in consistency with NASD 2711.
- ***Analysts' Activities:*** Dealers must pre-approve all outside business activities of their analysts.
- ***Guidelines into Standards:*** A number of "guidelines" have been elevated to mandatory "standard" status, including the requirement that a dealer may not provide research on an issuer if a supervisory analyst serves as an officer or director of the issuer.

"Pro Group" Disclosure Requirements

In a June 4, 2003 speech, the President and Chief Executive Officer of the IDA highlighted harmonization between the Canadian and U.S. regulatory regimes as an important issue for securities dealers. To that end, the IDA announced that the proposed requirement for dealers to report "pro group" holdings of over 5% in research reports (where pro group was defined very broadly) would be modified to follow NASD 2711, thereby requiring disclosure at the 1% level. Disclosure will be required when a dealer and its affiliates (but notably not its employees) beneficially own 1% or more of any class of the issuer's securities. It should be noted that NASD 2711 is restricted to pro group disclosure with respect to common equity securities of an issuer while Policy No. 11 proposes disclosure in respect of both equity and fixed income securities.

Implications

The IDA has acknowledged that "there is no doubt that these rules are tough". Revised Policy No. 11 will result in significant changes to the practices of dealers relating to their analysts and the separation of analysts from investment bankers.

For earlier information on this topic, please refer to our related Updates of March 20, 2002, August 21, 2002 and May 13, 2003.

We would be pleased to continue to assist dealers in evaluating current practices, as well as with the development of policies and procedures that comply with revised Policy No. 11. We invite you to contact any member of the Goodmans securities team to discuss the Policy.

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