

Corporate Securities

MARCH 20, 2002

Rules Relating to the Supervision and Practice of Securities Industry Analysts

Introduction

The Investment Dealers Association of Canada (the "IDA") is in the process of drafting rules (the "IDA Rules") to address conflicts of interest encountered by investment dealers and the research analysts employed by dealers in the preparation of research reports. We understand the IDA Rules will reflect recommendations and proposals from sources that include the 2001 final report of the Securities Industry Committee on Analyst Standards (the "Committee Report") prepared for the IDA and the Toronto Stock Exchange and the recent proposed rule change to establish NASD Rule 2711 of the National Association of Securities Dealers, Inc. (the "NASD Proposal") in the United States. See our Update of April 30, 2001 for a discussion of the Committee Report.

The Committee Report and the NASD Proposal share the goal of improving the objectivity of research. Both include recommendations with respect to: (i) disclosure requirements for research reports; (ii) standards to clarify analyst rating systems; (iii) requirements with respect to approval of research reports; and (iv) prohibitions on analyst trading prior to dissemination of research.

The NASD Proposal is more stringent than the Committee Report. While the Committee Report emphasizes increased disclosure requirements for the most part, the NASD Proposal includes more prohibitions and restrictions on dealers and research analysts as described below.

The NASD Proposal is currently being considered by the Securities and Exchange Commission. Draft IDA Rules are presently with IDA members for comment. The Rules will likely go before the IDA board of directors for approval in early April and be forwarded to the Ontario Securities Commission (the "OSC") for review. The OSC will then publish the proposed IDA Rules for public comment. We will prepare another Update when the IDA Rules are released by the OSC.

Key Recommendations

Key recommendations in the NASD Proposal include:

- prohibiting employees of a dealer's investment banking department from supervising its research analysts;
- restricting research analysts from submitting their reports to the subject company before publication except under limited circumstances;
- prohibiting dealers from compensating their research analysts based on specific investment banking transactions;
- prohibiting dealers from offering favourable research to a company as consideration/inducement for receipt of business;
- prohibiting a dealer from publishing a research report on a company for which the dealer has acted as manager or co-manager on an initial public offering within 40 days, or of a secondary offering within ten days, unless such research report concerns a significant event and is authorized by the legal and compliance departments;
- prohibiting a research analyst from trading in securities issued by a company that the research analyst has followed for a period beginning 30 days before, and ending five days after, the publication of a research

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report concerning the company except under limited circumstances;

- disclosure in research reports and public appearances of any financial interest held by the dealer, the research analyst, or a household member of such research analyst in the subject company;
- requiring a dealer to disclose in a research report compensation received from the subject company within the 12 months before, or a reasonable expectation of receiving compensation from the subject company within the three months following, publication of the research report;
- requiring the dealer to disclose in each of its research reports the percentage of companies in its “buy”, “hold/neutral”, and “sell” categories and also the percentage of subject companies within each of the three categories for which the dealer has provided investment banking services within the previous 12 months; and
- inclusion in reports of a price chart that maps the price of a security over time and indicates points at which the analyst assigned or changed a rating or price target.

Conclusion

The IDA Rules are intended to promote analysts’ reports and recommendations being objective, candid and independent in an effort to improve the integrity of the Canadian markets. It will be interesting to see the extent to which the IDA adopts the restrictions proposed by the NASD.

We invite you to contact any member of the Goodmans securities team to discuss the supervision and practice of securities industry analysts.

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