

MEMBER REGULATION



INVESTMENT DEALERS
ASSOCIATION OF CANADA

notice



ASSOCIATION CANADIENNE DES
COURTIERS EN VALEURS MOBILIÈRES

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MR0248

October 27, 2003

ATTENTION:
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Chief Financial Officers

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Policy No. 11

This Notice provides guidance to Members in developing and implementing their written policies and procedures with respect to Policy No. 11. Policy No. 11 has been developed to control potential conflicts of interest and promote high standards of ethical behavior in the preparation and publication of research. In order to achieve this goal, analysts must be subject to standards designed to enable them to maintain the independence of their research in an environment in which serious conflicts of interest are common.

Please note that Policy No. 11 sets out the minimum procedural requirements that Members must meet when publishing research reports. All policies and procedures must be approved and filed with the Association.

Policy No. 11 applies to both equity and fixed income research reports as evident under requirement 2(a) which states that "each Member shall prominently disclose in **any research report.**" While a number of the requirements only require disclosure of equity security holdings, Members are still required to disclose this information in fixed income research report.

I. Definitions

Policy No. 11 contains a number of definitions that should be included in Member's policies and procedures. The following matters require consideration:

- 1) The definition of "analyst" includes a "holding out" provision as well as those whose "responsibilities to the Member" include the preparation of research reports. The latter part of the definition is meant to include those that are employed as analysts, whatever their title, and not those employed as registered representatives who may happen to produce their own reports and recommendations that are similar to research reports. Such communications from registered representatives are governed by IDA By-law 29.7. However, Members should ensure that such registered representatives do not hold themselves out as analysts or suggest that their reports, instead of just expressing their own conclusions, have the imprimatur of the firm.
- 2) The definition of "research report" is broad, so as to encompass any material distributed to clients or the general public which contains an analyst's recommendation concerning the purchase, sale or holding of a security. The definition may not be limited to the formal published report. For instance, it could include sales and trading communications making reference to an analyst's recommendation. Sales and marketing material that do not make reference to an analyst's recommendation are covered under By-law 29.7, not Policy No. 11. However, Members should ensure that those preparing sales and marketing material are aware of the definition so as not to inadvertently issue something that would fall under Policy No. 11.
- 3) The following also fall outside the definition of research report:
 - a) Reports with respect to Government debt;
 - b) Reports with respect to Government guaranteed debt; and
 - c) Market analyses, market index and sector reports.
- 4) Fixed income securities do not use the same language in recommending securities as used in the equities markets. Providing factual information such as coupon rate, term, par amount, weight in indices and debt ratings issued by third party agencies does not constitute the making of a recommendation. However, terminology used with respect to fixed income securities that constitute an implied recommendation, such as stating that an issue is under-priced, would be considered to be a recommendation and would bring the report within the definition and requirements of a research report.

II. Requirement 2(a)

Requirement 2 is the general disclosure provision, which states that a Member must "disclose any information regarding its, or its analyst's business with or relationship with any issuer which is the subject of the report which might reasonably be expected to indicate a potential conflict of interest." This obligation goes beyond the specific conflicts delineated in the rest of the Policy. Members are required to exercise their judgment in determining what is material and must therefore be disclosed as they are in the best position to know what facts of any particular case will trigger their primary obligation to disclose potential conflicts. For instance, Members will have to make a judgment as to when investment-banking discussions become firm enough to put the Member in a potential conflict of interest requiring disclosure. When in doubt the firm should err on the side of caution and make the necessary disclosure.

III. Requirements 2(a)(ii), (iii) and (vi)

- a) Requirement 2(a)(ii) uses the language "any individuals directly involved in the preparation of the report." Individuals that would be included are those directly involved in preparing the substance of the report, not administrative or clerical staff who are peripherally involved.
- b) Requirement 2(a)(iii) requires partners, directors or officers of a Member, as well as any analyst involved in the preparation of the report, to disclose if they have provided services to the issuer for remuneration in the preceding 12 months. The disclosure is required whether they receive fees for services acting on behalf of the Member or for services provided in their personal capacity. However, this does not include normal course investment advisory or trade execution services, as the Association agrees that an issuer having an account at a Member through which to conduct its own trading activities would not be relevant. Moreover, disclosure duplicative of that required under Requirement 2(a)(iv) is not necessary i.e. the disclosure of an investment banking relationship between the issuer and the Member covers all of the partners, directors or officers who may have been involved in that relationship.
- c) Requirement 2(a)(vi) deals with making a market in the security. For the purpose of this requirement, making a market means making a market in an equity or equity related security of the issuer. However, Members are still required to disclose in a fixed income research report if the Member is making a market in an equity or equity related security.

IV. System for Rating Investments

Requirement 2(b) requires the disclosure of Member's system for rating investments. This applies to both equity and fixed income securities but does not require that the same system be used for both types of securities. The rating system disclosure can be limited to the system for the type of security that is the subject of the report.

V. Dissemination of Research

Requirements 2(c) and 6 state that Members must disclose in any research report its policies and procedures regarding the dissemination of research. Such information would include: (i) to whom its research is available (e.g. clients only); (ii) how research is disseminated (e.g. electronically and/or in printed form); and (iii) whether all recipients receive the research at the same time.

VI. Public Comments

A public comment for the purposes of Policy No. 11 would include " any comment made while participating in a seminar, public forum (including an interactive electronic forum), radio, television, interview or other public speaking activity or the writing of a print media article in which an employee comments about an issue. As long as the Member has provided guidelines

and training for any employee or agent making such public comments, and the employee or agent makes reasonable efforts to disclose the existence of any relevant research report or the fact that one does not exist, they will be held to have satisfied the requirement under the Policy.

VII. Third Party Research

Requirement 4 deals with third party research and states that "where a Member distributes a research report prepared by an independent third party to its clients under the third party name, the Member must disclose any items which would be required to be disclosed under requirement 2 had the report been issued in the Member's name."

Where a Member simply provides access to independent third party research reports or provides independent third party research at the request of clients, the requirement for specific disclosure does not apply but Members must disclose that the research provided may not meet Canadian disclosure requirements. The disclosure may be generic, for example on a web page through which such reports are accessed provided that it is prominently placed where it is likely to come to the client's attention.

VIII. Trading Restrictions

Requirement 8 states that those directly involved in the preparation of a research report are prohibited from trading in a security of the issuer, or a derivative instrument whose value depends principally on the value of a security of the issuer, for a period of 30 calendar days before and 5 calendar days after issuance of the research report, unless that individual receives the previous written approval of a designated partner, director or officer of the Member.

Fixed income research reports often cover multiple bonds and issuers and could be seen to be making recommendations with respect to certain classes of issuers or sectors of the market. The restriction periods in Requirement 8 only apply to security-specific recommendations not to sector or class recommendations.

IX. Revenue Based Compensation

Requirement 9 requires disclosure if the analyst preparing a report has in the past 12 months received compensation based on investment banking revenue. This does not include disclosure of compensation based on the overall revenues or profits of the Member, which may include investment banking revenue or profits. Disclosure is required only where the analyst's compensation is tied directly to the general level investment banking revenue. Requirement 10 specifically prohibits the tying of analyst compensation to specific investment banking transactions or groups of transactions.

X. Analysts' Site Visits

Requirement 13 requires disclosure if and to what extent an analyst has viewed the material operations of an issuer. Members are also required to disclose if the analyst's travel expenses were paid or reimbursed by the issuer for such a site visit. The disclosure is required for any

visit made whether or not it was in connection with the preparation of the report as it would be impossible to determine whether a later research report was based at least in part on information obtained during such a visit.

XI. Quiet Periods

Requirement 14 prohibits Members from issuing research reports for equity or equity related securities of an issuer for 40 calendar days after initial public offerings or 10 calendar days after secondary offerings they have managed or co-managed. This means that Members can publish such reports on the 41st and 11th day respectively.

For the purposes of Requirement 14 a secondary offering refers to any public offering other than an initial public offering.