

April 24, 2015

Marsha Gerhart
Vice President, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
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Dear Ms. Gerhart,

RE: **Proposed Changes to IIROC Rule 3400 Research Restrictions and Disclosure Requirements**

As a follow up to our earlier conversation, I am writing to provide IIROC with information regarding a FINRA proposal to amend its rules relating to research analysts and research reports and request that IIROC consider similar amendments to IIROC Rule 3400.

By way of background, as part of the process of developing a new, consolidated rule book, the Financial Industry Regulatory Authority (FINRA), FINRA sought comment on proposed research analyst conflict of interest rules. FINRA Rule 2241 Research Analysts and Research Report, adopts NASD Rule 2711 as a FINRA Rule, with several modifications. The proposed rule change would also amend NASD Rule 1050 Registration of Research Analysts and incorporate and consolidate certain NYSE Rules.

On November 14, 2014 FINRA filed the proposed Rule 2241 with the Securities and Exchange Commission. The Rule was published for comment and FINRA will announce the effective date of the propose rule change in a Regulatory Notice to be published no later than 60 days following SEC approval. The effective date will be no later than 180 days following publication of the Regulatory Notice announcing SEC approval.

IIROC Rule 3400 (previously IDA Policy No. 11) came into force on February 1, 2004. Prior to that there were no comprehensive by-laws, regulations or policies that specifically addressed research analyst conflicts of interest. As serious conflicts of interest can arise, it was determined that uniform rules needed to be established to assist individuals who rely on analyst recommendations and to ensure investor confidence. Policy No. 11 was based largely on the report of the *Securities Industry Committee on Analyst Standards* (the Crawford Report), published in October 2001, as well as rules regarding analysts in the United States.

Requirement 14 of IROC Rule 3400 states in part, that:

No Dealer Member may issue a research report for equity or equity related security regarding an issuer for which the Dealer Member acted as manager or co-manager of

- (i) an initial public offering of equity or equity related securities, for 40 calendar days following the date of the offering; or
- (ii) a secondary offering of equity or equity related securities, for 10 calendar days following the date of the offering.

The IIAC, on behalf of our Research Analyst Standards Working Group, is writing to request changes to IROC 3400 dealing with Research Restrictions and Disclosure Requirements in order to retain consistency with the proposed FINRA Rule 2241.

In December 2005, the NASD and NYSE put out a Joint Report on the Operation and Effectiveness of the Research Analyst Conflict of Interest Rules at the request of the SEC. The SEC had requested that a review take place to ensure that the Rules were effective and necessary. Following the issuance of the Joint Report in 2005, the NASD put out proposals to amend a number of the provisions contained in the NASD and NYSE Rules.

One of these proposals, now contained in FINRA Rule 2241 is an amendment to the quiet periods during which a member is prohibited from publishing or otherwise distributing research reports.

Under the FINRA proposal, quiet periods would be reduced from 40 days to 10 days for an initial public offering and 10 days to three days for a secondary offering.

In the SEC published filing, FINRA explains the rationale for the proposed rule change as follows:

The lengthier quiet period for managers and co-managers was intended to allow other voices to publicly analyze and value a subject company before members most vested in the success of the offering expressed a view in their reports and public appearances. However, in light of the objectivity safeguards in other provisions of the research rules and the certification requirement of SEC Regulation AC, FINRA believes it is no longer necessary to impose a longer period on managers and co-managers. Both the Joint Report and the GAP Report noted that analysts have been issuing less optimistic recommendations since the regulatory reforms, particularly at firms involved in underwriting subject company securities. FINRA believes that the separate, disclosure and certification requirements in the rules and Regulation AC have had greater impact on the objectivity of research than maintaining quiet period during which research may not be distributed and research analysts may not make public appearance. FINRA has observed – and media report have documented – instances when a manager or co-manager of an IPO has initiated coverage of the subject company with a “hold” or even “sell” rating once the quiet period ended.

These examples buttress FINRA's belief that the other provisions of the rules and Regulation AC have been effective in deterring biased research. FINRA also notes that there is a cost to investors when they are deprived of information and analysis during quiet periods.¹

FINRA also goes on to note that it believes that the proposed rule change would promote more information flow to investors without jeopardizing the objectivity of research.

The U.S. quiet period rules are mirrored in Requirement 14 under IIROC Rule 3400, which was based on the NASD provision when originally drafted. We suggest that IIROC make a similar change to Requirement 14. This will ensure consistency with proposed Rule 2241, which is critical for members, especially those with large integrated cross-border operations.

The IIAC appreciates that the requirements of Canadian and U.S. markets are distinct; however, we that believe that in this specific area, having research black-out period of varying lengths could be disadvantageous to Canadian investors. This would occur when Canadian produced research is disseminated simultaneously north and south of the border but IIROC members would be locked into a more restricted blackout period as currently required under Rule 3400.

If research is disseminated in the U.S. and not in Canada due to different hold periods, inconsistent rules in this area would put Canadian investors at a disadvantage. In addition, once research is issued in the U.S. it will undoubtedly filter into Canada and as such, for consistency and fairness; the rules should be the same.

We recognize the fact that the FINRA proposal is not yet in effect, but given the time required to draft the amendments, receive the necessary approvals and publish the rules for comment, the IIAC suggests that IIROC commence the rule review process as soon as possible to avoid any issues caused by gaps in the IIROC Rules.

Yours sincerely,



Michelle Alexander
Vice President and Corporate Secretary
Investment Industry Association of Canada

Cc: Paul Riccardi

¹ See <http://www.finra.org/industry/rule-filings/sr-finra-2014-047>