August 24, 2009

Mr. Jamie Bulnes
Director, Regulatory Policy
Investment Industry Regulatory Organization of Canada
121 King Street West
Suite 1600
Toronto, Ontario
M5H 3T9

RE: IIROC PROPOSED RULE 3900 (CURRENTLY RULE 3400)

Dear Jamie:

The IIAC, on behalf of our Research Analyst Standards Committee ("Committee"), is writing in response to your memorandum dated July 24, 2009 which proposes changes to IIROC proposed Rule 3900 (currently Rule 3400) (the "Rule") dealing with Research Reports.

The Committee has a number of concerns regarding changes to the Rule which are outlined below.

Definitions

The Committee is particularly concerned with the addition of the requirement to report firms' financial interest in debt securities when issuing research reports. Currently, the Rule only applies to equity securities but under the proposal it would apply to both debt and equity.

Debt securities have not been defined under the Rule and our Committee requests that this term be clarified. Debt securities do not possess the same characteristics as equity securities and numerous questions arise when determining what disclosure would be necessary.

There are also numerous changes to the Rule where the term derivative has been removed. We are unclear if "derivatives" are still of issue or if they are now encompassed under the term debt.

Proposed Rule 3907(2)(vii) states that a dealer must disclose whether it is making a market in any security of the subject issuer. We are unclear if the term "any security" applies to debt. The term "market maker" does not apply in the debt world as this is a principles-based market.

The Committee would also like IIROC to clarify what is meant by "initial public offering". This term does not have the same meaning for debt securities as it does for equity securities. Furthermore, every issue of a debt security could technically be termed an initial public offering due to the nature of the security and therefore, we request clarification as to what the intention was behind the use of this term? A better approach might be to state that no research should be issued on debt securities until closing.

Debt Securities - Significant Financial Interest

The Committee is particularly concerned with changes to proposed Rule 3907(2)(i) which requires that members disclose whether they have a significant financial interest in the debt securities of the issuer. We are unclear what is meant by the phrase "significant financial interest" and request further guidance on this phrase. The proposed amendment assumes that members are able to accurately track outstanding debt. The Committee is of the opinion that this assumption is flawed as this type of information is not readily available to individual dealers. This information cannot be extracted from the marketplace in the same manner as with equity securities and would need to be done by an organization such as CDS which would have its own set of complications.

The reasons underlying our concerns regarding a dealer's ability to accurately track debt issues are as follows:

1. Over-the-counter-markets: these markets do not have a central source of data on amounts outstanding or issuances;
2. No dealer is involved in all public deals, or even necessarily knows about them: this frustrates efforts to track amounts outstanding even if a dealer decides to bear the administrative costs;
3. Private placements: reviewing websites for issuers that have issued debt securities under private placements frequently reveals previously unknown new issue debt issues (both private placements and buybacks);
4. Tap issues (such as the Quebec RRB issue program): in this scenario, dealers identify accounts that want to buy a particular issuer's bonds. Based on these potential buyers, dealers make private bids to the province to purchase them. No one knows how much is outstanding except the province, and there is sometimes a significant time lag before the information is published;

5. Size of market: large dealers could have as many as 15,000 securities in its fixed income database, about 8,000 of which are standard "coupon paying" bonds, but there are thousands more that are not tracked. It is simply not possible nor practical to do so given that, unlike equity markets, issuers can have many different bonds outstanding;
6. Stripping and reconstitution activity: when a bond is stripped, the amount outstanding effectively declines. A reconstitution of strip bonds into a "coupon paying" bond causes an increase in amount outstanding. This is virtually impossible to track;
7. How does one account for holdings of strip coupons? A $100 mm, 30 year 5% bond generates strip bonds with an aggregate face value of $250 mm, $100 mm of which is the principal piece. Obviously, members cannot track the amount based on face amounts, and it is more difficult still to track based on market values. The data on stripping activity is available from CDS monthly, but this data feed has not been reliable historically; and
8. Some bonds have laddered, or uncertain, principal repayment schedules: dealers often receive calls from clients asking for help determining how much is outstanding on such issues – and clients have the benefit of full information at the time that they purchase the issue. Dealers often do not have access to such details unless they are in the original deal syndicate.

Based on the above, complying with this proposed requirement is virtually impossible.

Quiet Periods

The Committee also has concerns with the proposed changes to the requirement dealing with quiet periods. In addition to the 40 and 10 day quiet period for equity securities, the proposed Rule will now apply to debt securities as well.

In December 2005, the NASD and NYSE put out a joint report ("Joint Report") on the Operation and Effectiveness of the Research Analyst Conflict of Interest Rules at the request of the Securities and Exchange Commission ("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 their rules which have not yet been finalized.

One of the changes proposed in the Joint Report was to reduce quiet periods for initial public offerings ("IPOs") to 25 days and to eliminate quiet periods for secondary offerings. Since the Joint Report was published, the Financial Industry Regulatory Authority ("FINRA") has proposed additional changes to the quiet periods and is proposing reducing these timelines further. Initially, the quiet period was to be reduced from 40 days to 25 days for an IPO and no quiet period would exist for secondary offerings. Recently, FINRA announced that they were considering only a 10 day quiet period for IPOs. The logic behind making such changes is that FINRA found that managers and co-managers have been neutral or even negative with their initial post-quiet period report based on price appreciation and other factors and, therefore, the lengthy period may not be required. Furthermore, it was felt that the amendment would increase

the flow of information to investors without sacrificing the reliability of the research. It should also be noted that the U.S. rules for quiet periods do not apply to debt securities.

When IIROC originally drafted the analyst standards rules the quiet period provisions were drafted to mirror the NASD Rule. As such, we request that IIROC make the same changes as being proposed in the U.S. to ensure consistency. It is important for dealers to be subject to similar requirements, especially for those dealers with large integrated cross-border operations. We appreciate that in some instances, distinctions between the Canadian and U.S. markets necessitates different regulatory requirements. However, we feel that in this specific area, having research black-out periods of varying lengths could be disadvantageous to Canadian investors.

Furthermore, debt securities should not be subject to quiet periods in the same manner as equity securities. We are not aware of any evidence that debt research can have an effect on the price/value of a debt security or the issuer name.

Additionally, many well-established issuers come to marketplace several times per year. Quiet periods may result in it being difficult or impractical to write on the issuer with any regularity. Moreover, only a few dealers have established debt research franchises. Because they are involved as syndicate members in a large number of debt offerings, quiet periods may result in the cessation of all/most of the debt research each time an issuer comes to market. This is not a concern in the equity market because there could be as many as 10-20 different analysts covering the issuer and if 5 have to go quiet, 15 could still publish. However, if IIROC determines that quiet periods should apply to debt we request it should not apply to investment grade securities.

As outlined above, there are many outstanding issues surrounding the inclusion of debt in the proposed Rule. The IIAC Research Analyst Standards Committee would be happy to meet with IIROC to discuss these issues further. Thank you for considering our recommendations.

Sincerely Yours,

Deborah L. Wise
Assistant Director, Policy