

**SETTING ANALYST STANDARDS:  
RECOMMENDATIONS FOR THE SUPERVISION AND  
PRACTICE OF CANADIAN SECURITIES INDUSTRY ANALYSTS**

**FINAL  
REPORT**

**SECURITIES INDUSTRY COMMITTEE ON ANALYST STANDARDS**

**OCTOBER 2001**

**TORONTO STOCK EXCHANGE • INVESTMENT DEALERS ASSOCIATION • CANADIAN VENTURE EXCHANGE**



Toronto Stock Exchange



SETTING ANALYST STANDARDS: SECURITIES INDUSTRY COMMITTEE ON ANALYST STANDARDS

FINAL REPORT

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## COMMITTEE MEMBERSHIP

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Osler, Hoskin & Harcourt  
*Chairman*  
AT&T Canada

### MEMBERS

Gordon Cheesbrough  
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Leo G. Ciccone  
*Vice President, Compliance*  
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*Vice President, Public Markets Equities Branch*

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Petro-Canada Inc.

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*Vice President and Director, Research*  
RBC Dominion Securities Inc.

Joan C. Smart  
*Managing Director, Head of Compliance*  
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Investment Dealers Association of Canada

Maryn Sigurdson  
*Vice President, Regulatory Affairs and  
Corporate Secretary*  
Canadian Venture Exchange

### CSA OBSERVER

Peggy Dowdall-Logie  
*Manager, Registrant Regulation*  
Ontario Securities Commission

### STAFF

Nean Allman  
Ian Ferguson  
Alice Janisch

We are pleased to present the final report entitled *Setting Analyst Standards: Recommendations for the Supervision and Practice of Canadian Securities Industry Analysts*. The Committee has reviewed the current practice of Canadian securities industry analysts, consulted widely and received a number of submissions on the Draft Report that was published in April 2001.

During our deliberations the Committee spoke with or received submissions from representatives of dealer firms, professional associations, academia, dealer-employed analysts, independent analysts, institutional investors, retail investors, public companies and securities regulators. Seventeen written submissions and 28 presentations were received to help formulate the Draft Report. A further 28 written comment letters were received on the Draft Report. All comments were considered and certainly helped in the formulation of the final recommendations.

It was evident throughout this process that the public is very interested in what influence analysts have in the marketplace. In the United States, reviews of analysts' practice by both the financial industry and the Securities and Exchange Commission (SEC) testify to the same investor interest. We are also aware that, since the Committee was formed, some investment dealers have made changes to their internal policies and practices that address some of our concerns. We applaud these moves, and encourage more to follow suit.

This report contains our final recommendations for industry-wide initiatives we believe should be undertaken to improve the independence and professionalism of Canadian securities industry analysts. There is no question that analysts play a fundamental role in the capital markets. We believe that in order to maintain the integrity of the marketplace securities industry analysts must operate effectively and efficiently while maintaining the highest standards of ethical behavior. To achieve this, all analysts must adhere to a code of ethics

and high standards of professional conduct. These standards are necessary to enable analysts to work in environments where serious conflicts of interest are common and where these conflicts must be effectively managed or avoided in order to maintain the independence of research.

We believe that most securities industry analysts try to conduct independent research and that most abide by the Code of Ethics and Standards of Professional Conduct mandated by the Association for Investment Management and Research AIMR. Unfortunately, this is not always the case. We reviewed several situations where it appeared that research and the ensuing recommendations were far from independent and where it appeared that the investment dealers' needs superceded those of their investor clients. It is precisely these situations that illustrate the need for the changes that we recommend.

We offer 33 recommendations for changes to both the standards of practice for analysts and the standards of supervision for analysts within the Canadian marketplace. There is no question that analysts work in a complex environment and that any change to their practice will be assisted by the support of the companies for which they work and the companies that their research covers. Many of our recommendations therefore focus on the supervision of analysts and standards for their business relationships, rather than merely on rules for the analysts themselves.

Our recommendations also include mandatory disclosure of conflicts to ensure that investors have enough information to understand the basis for an analyst's research recommendations and to be aware if either analysts or their employers are in a position of conflict. In cases where we believe that disclosure of conflicts is not enough to mitigate the conflicts, we have recommended that those particular conflicts or associations be prohibited completely.

We would like to comment on the importance of good corporate governance for public companies and how this impacts analysts. This subject is of significant importance to the marketplace and one which we have referred to the Joint Committee on Corporate Governance (the Saucier Committee) for consideration. The relationship between companies and analysts who write research on these companies should be of concern to the entire business community, since it affects the value of research in the market. It is important that public companies do not put pressure, either directly or indirectly, on analysts in an attempt to influence the outcome of research. Ensuring that this type of pressure is not applied to analysts who cover a company is not only important to the market but also to the company and its reputation. It is the duty of the board of directors to monitor a company's communications policy and how that policy is applied in that company. We encourage the Saucier Committee to address this concern during its deliberations and to ensure that its final report includes a recommendation to address this issue.

Good corporate governance is also important within investment dealer firms. When the day is done, the most effective way to develop the independence and professionalism of analysts employed by dealer firms is for the dealers' boards of directors and chief executive officers to "walk the talk" of good governance and strong ethics. Boards and CEOs of sell-side companies who want their analysts to be independent and to maintain high professional standards will make it happen. While some of our recommendations deal specifically with these matters it will be the leaders who set the tone and vision for the independence and professionalism of their analysts. We believe it is imperative that they do so to protect the standards of the marketplace. Similarly, independent analysts, namely those not employed by corporations, and newsletter writers should operate under similar high standards.

Institutional investors play a major role in the market place, and have the power to influence analysts' practice strongly. As indicated on page 56 of this report, some are starting to play a significant role in assessing the quality of security analysts. This is a development that we applaud. We would like to see institutions continue this practice and, to the extent feasible, allocate commission business based upon the quality of research.

In drafting these recommendations we have been very sensitive to the need for balance. We endeavored to propose recommendations that are in the best interests of investors and weighed them carefully against the costs that would be imposed by their implementation. We tried to recommend the least intrusive market solution for the issues. We are confident that the implementation of our recommendations will improve the marketplace. We believe our proposals will support a vibrant capital market and will command the confidence of investors both at home and abroad.

Our report is the result of a great deal of time and effort by many people. I would like to thank the members of the Committee for providing their time, experience and critical reasoning to this process, and the representatives of the Toronto Stock Exchange, the Investment Dealers Association of Canada, the Canadian Venture Exchange and the Canadian Securities Administrators who have worked so hard to support this project. In particular I would like to thank Nean Allman, Ian Ferguson and Alice Janisch who all worked hard to support the Committee.

We urge the financial industry including the regulators, exchanges and industry participants cited in our recommendations to act expeditiously in making the changes suggested in our recommendations.

The implementation process will require our sponsoring organizations, in particular the Investment Dealers Association of Canada, to draft changes to

regulations that will then be forwarded to the Ontario Securities Commission and Canadian Securities Administrators for approval. We urge all involved to work together to implement these recommendations expeditiously. While the Committee has fulfilled its stated purpose by producing this Final Report, members of the Committee intend to monitor the progress of the implementation of the 33 recommendations.

Yours truly,



Purdy Crawford  
Chairman SICAS



James B. McLeod



Gordon Cheesbrough



Joan C. Smart



Leo G. Ciccone



Maureen Jensen



Michael Jalonon



Gerald Romanzin



Claude Lamoureux



Ian Russell



Deborah Leckman



Maryn Sigurdson



Brian F. MacNeill

**PREAMBLE**

The Toronto Stock Exchange (TSE), the Investment Dealers Association of Canada (IDA) and the Canadian Venture Exchange (CDNX) established the Securities Industry Committee on Analyst Standards (SICAS) in September 1999, in response to a number of concerns that were being raised about the role that analysts play in promoting stocks in the marketplace. In particular, the Final Report of the Mining Standards Task Force released in January 1999 had recommended that an industry committee be formed to establish minimum industry standards governing the supervision and conduct of all securities research analysts since that committee established that analyst recommendations are as important to investors as information released by public companies.

The Committee's mandate was to:

- review the practices and activities of securities research analysts (analysts) in Canada;
- review the standards of conduct and supervision of analysts; and
- report on securities industry standards governing the conduct and supervision of analysts, and make appropriate recommendations regarding the conduct and supervision of analysts to preserve the integrity of the capital markets.

The Committee membership was drawn from different sectors of the securities industry, and included representatives of investment dealers, institutional investors, listed companies and self-regulatory organizations. After soliciting input from the public, the Committee received 17 written submissions and 28 presentations from organizations that provided valuable input to the draft recommendations. The Draft Report, containing 28 preliminary recommendations, was published in April 2001 and a total of 28 letters were received commenting on its draft recommendations. This Final Report presents the

Committee's final 33 recommendations for changes to the practice of securities industry analysts and standards of supervision for these analysts.

The Committee strove to understand the issues and underlying causes presented to its members, and has endeavored to strike a balance in its recommendations that will allow for the protection of investors and foster a fair and efficient capital market. In formulating the recommendations in response to each issue or concern, the Committee attempted to choose the least intrusive option that would both allow firms to operate efficiently on a cost-effective basis and permit analysts to operate as independently as possible. The objective of the Committee's recommendations is to foster market integrity, and to strengthen the ability of analysts to give objective, independent, opinions without suffering deleterious consequences.

Please note that in this report, unless otherwise noted, the words "conflict" or "conflicts" refer to a conflict of interest or conflicts of interest. Conflicts of interest may be potential, perceived or real, but for the purposes of this report, the Committee addresses them all as conflicts of interest.

**THE ANALYST'S ROLE**

The generic term "analyst" applies to several different functions within the securities industry. Analysts working at full-service investment dealers are typically referred to as "sell-side" analysts, while those employed by institutional investors are on the "buy-side." Other analysts selling their research on a subscription or other basis are often classified as "independent." While many of the Committee's recommendations apply to all analysts, the Committee's report focuses principally on sell-side analysts, because of their potential influence on retail and small institutional investors.

Most sell-side analysts appear to play a multifaceted role for their firms. In general terms, analysts in a full-service investment dealer

contribute to two principal sources of revenue, commission-related (trading) revenue and investment banking revenue.

Analysts support trading revenue by generating investment ideas for clients of their firm. They do this by considering publicly-disclosed company information along with information they derive from their own sources, and interpreting all of it in light of their experience and insights to generate performance estimates for a company and ultimately a valuation and recommendation on the company's securities. Individual company analysis is generally presented relative to other comparable companies in a sector and within the context of industry trends, macroeconomic factors and commodity price forecasts.

Analysts also play a role in securing investment banking transactions. Analysts often suggest possible transactions for their investment banking colleagues to pursue and companies are in part drawn to select dealers based on the reputation and stature of the firm's research reputation. Analysts are also often involved in road shows or other marketing activities organized to present the analysts' views to institutional investors.

The potential size of investment banking fees, combined with other trends in Canadian capital markets over the past several years such as shrinking trading commissions and increased "foreign" competition, has resulted in an increase in the importance of investment banking revenues to most investment dealers. Consequently, the role of sell-side analysts in support of these revenues has also increased in importance. This has heightened the potential for conflicts arising between an analyst's duty to provide independent, objective, advice to investor clients and the pressures to support investment banking revenues through services to the firm's corporate clients.

The analyst's role within the marketplace has also been affected by the recent improvements

in access to information provided by the Internet. With information available instantaneously to whoever wants it, there is increased pressure on the analyst to add value to information made available by companies in order to ensure that research products are of value to investors.

#### REGULATION

Participants in the securities industry are regulated by provincial securities regulators, exchanges and other self-regulatory organizations (SROs), which include the Toronto Stock Exchange, Canadian Venture Exchange and Investment Dealers Association of Canada. Each province has securities legislation that requires individuals and companies that advise or trade to be either registered or exempted from registration for that purpose. At present, there is little of specific application to analysts in securities legislation or in the rules of the SROs. In the absence of specific rules governing analysts, any regulatory enforcement action due to a problem with an unregistered analyst would in most cases be limited to action against the dealer for failure to supervise the analyst. For example, the Toronto Stock Exchange has the power to sanction employees of its participating organizations but only with respect to infractions of trading rules.

A standard of practice does exist for analysts but it is not enforceable under securities law and it is not mandatory. The Code of Ethics and Standards of Professional Conduct of the Association for Investment Management and Research (AIMR) are the standards the Committee believes should be mandatory for all analysts unless, and until a "Made in Canada" code is developed (see recommendation 24). AIMR is an international non-profit organization which promotes educational standards for financial analysts. Its members are subject to the association's Code of Ethics and Standards of Professional Conduct, which are designed to ensure fair treatment for clients and high ethical standards of practice. AIMR has the

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power to investigate, hold hearings and sanction members who use the Chartered Financial Analyst (CFA) designation but is not a self-regulating organization and does not actively police compliance. Loss of membership is the sole sanction AIMR can apply to members who contravene the code or standards. While many analysts are members, AIMR membership is not a requirement for employment in the financial industry. The AIMR code and standards do set excellent benchmarks for analysts' professional standards and the Committee believes the code and standards should be enforced across the industry.

AIMR released a proposed issues paper for comment entitled *Preserving the Integrity of Research* on July 10, 2001. This paper is the first of a three-part initiative by AIMR to support independence and objectivity in research reports and recommendations. This first paper identifies and discusses the conflicts of interests and pressures experienced by analysts working for investment banking/brokerage firms that may bias their research reports and recommendations. The Committee is pleased by the leadership that AIMR has taken on this important issue and urges all analysts to review the paper and respond to AIMR's request for comments.

Specifically in the US, two other important initiatives have been released since the Committee's Draft Report. The US Securities Industry Association issued a paper entitled *Best Practices For Research*, which outlines "best practices" for dealer firms who generate research, and is an excellent initiative. An amendment has also been proposed to NASD Rule 2210, entitled *Communications with the Public*. (See pages 27, 53.) Each of these initiatives is lauded by the Committee. We do believe, however, that a combination of best practices and active enforcement is required.

### KEY ISSUES

The submissions and presentations made to the Committee identified several key issues that the Committee believes must be addressed by changes in practice and/or regulation. These issues include:

- The conflicts of interest that sell-side analysts face due to their employment at dealer firms and which of these conflicts should be disclosed, mitigated through mandatory standards or, in some cases, prohibited;
- The absence of enforceable disclosure standards for research reports;
- The absence of an enforceable code of ethics and standards of professional conduct for analysts, including independent analysts and newsletter writers;
- The practice of selective disclosure of important information by companies to analysts;
- The practice of companies, or institutional investors, pressuring analysts for positive coverage; and
- The failure of some investors to understand that analysts have to balance varying degrees of conflicts of interest.

### RECOMMENDATIONS

During its deliberations, the Committee realized that it was important to clarify the role of analysts in the market, to determine which conflicts could be balanced by disclosure and which ones should be disallowed, and to establish some standards of practice and disclosure to ensure investors are better protected. While most Canadian analysts are highly regarded and respected, it became clear that, especially on the sell-side, analysts are exposed to increasing pressures from internal and external sources as well as conflicts of interest. As a result their reports and recommendations are not always as objective, candid, or independent as they might be. Essentially, the Committee was made aware

that there are issues and concerns regarding analysts' standards that need to be addressed by changes in practice and/or regulation.

In developing its recommendations, the Committee chose wherever possible the least intrusive option, favoring mandatory disclosure over more intrusive responses. In the cases where the Committee believed that serious conflicts could not be managed by disclosure, prohibitions of these conflicts have been recommended. Throughout the deliberations every effort was made to balance the benefits against additional costs.

Before compiling the Final Report, the Committee sought comments from all interested parties on the Draft Report. We received 28 comment letters, from 10 sell-side firms, one buy-side firm, four shareholder representatives, one independent research firm, six professional associations and six individuals. Most letters offered support for the thrust and recommendations of the report, and focused their commentary on only the key issues with which they either emphatically agreed or disagreed. A discussion of some of the key comments on the Draft Report appears within the Preface on page 17.

The 33 recommendations are grouped into five distinct sections:

- Disclosure in research reports;
- Best practices for research reports;
- Registration and supervision of analysts;
- The importance of corporate governance to analyst independence; and
- The importance of education in the marketplace.

The recommendations are set out in full below, in the order in which they are presented in Section 4 of this report. We suggest that the recommendations be read in conjunction with the commentary in Section 4. While most of the recommendations

remain as in the Draft Report, some changes have been made in response to comments received on the Draft Report or otherwise. We are grateful for the comments received as they have added significantly to the report, and have also resulted in five additional recommendations.

#### DISCLOSURE IN RESEARCH REPORTS

1. The Committee endorses the concept of Pro Group reporting recommended in the Report of the Joint Securities Industry Committee on Conflicts of Interest, where the Pro Group is defined as in proposed IDA By-law 29.15(a) and proposed TSE By-law 689 section 1.01; and encourages the industry to implement this reporting requirement rapidly. (See page 46)
2. We recommend that the stock exchanges and the Investment Dealers Association of Canada require their members and participating organizations to disclose specific conflicts of interest in each research report and recommendation they issue on a company, including:
  - a) the Pro Group's holdings of any class of the company's securities, whether long or short, which in the aggregate exceed 5% of the outstanding securities of that class, as at a specified date;
  - b) if the analyst responsible for the report or recommendation and the analyst's associates hold or are short in any of the company's securities, directly or through derivatives;
  - c) if remuneration or other benefit has been or will be received by any member of the Pro Group from the company for services, and if the member firm has acted as an underwriter or adviser during the 24 months preceding the report or recommendation. (See page 47)
3. We also recommend that such disclosure be readable and displayed prominently whether printed or disseminated electronically. In a

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summary report, where a brief comment may be made on a company, the investor should be referred to a previous full research report where this disclosure has been made, if one exists, or a comment should be made that such a report does not exist or may be forthcoming. (See page 47)

4. We recommend that the Investment Dealers Association of Canada and the stock exchanges prohibit an analyst employed by a member or participating organization from issuing research on a company when the analyst serves as an officer, director, employee, or serves in any advisory capacity to the company. (See page 48)
5. We recommend that the stock exchanges and the Investment Dealers Association of Canada require their members and participating organizations to disclose prominently, in each research report or recommendation on a company, the name of each director, officer and employee of the dealer who is a director, officer or employee of the company, or who serves in any advisory capacity to the company. (See page 48)
6. We recommend that securities regulatory authorities require independent analysts and newsletter writers to disclose in their published research reports and recommendations on a company:
  - a) if the independent analyst or newsletter writer, or their associates, hold or are short in any of the company's securities, directly or through derivatives;
  - b) if remuneration or other benefit has been or will be received from the company for services during the 24 months preceding the report or recommendation;
  - c) if the independent analyst or newsletter writer is a director, officer or employee of the company or serves in any advisory capacity to the company. (See page 49)

7. We also recommend that such disclosure as required by recommendation No. 6 be displayed prominently in the published reports and newsletters of the independent analyst or newsletter writer. (See page 49)

## BEST PRACTICES FOR RESEARCH REPORTS

8. We recommend that the Investment Dealers Association of Canada require its members to distinguish clearly in each research report between information provided by the company or obtained elsewhere and the analyst's own assumptions and opinions. (See page 50)
9. We recommend that the Investment Dealers Association of Canada require its members to disclose in their research reports and recommendations reliance by the analyst upon third party experts other than the analyst responsible for the report, and to name the third party experts. (See page 51)
10. We recommend that the Investment Dealers Association of Canada require its members to disclose in their research reports if and to what extent the analyst has viewed the material operations of a company, in circumstances where such visits would assist in the analysis of the company's operations and would be material to the report. (See page 51)
11. We recommend that the Investment Dealers Association of Canada require its members to explain the meaning of the recommendation or rating used in each research report, and where that ranking fits within the full range of recommendation terminology employed by the analyst. (See page 52)
12. We also recommend that investment dealers disclose on their websites or otherwise, on a quarterly basis, information available to the public as to the percentage of their recommendations that fall into each category of their recommendation terminology. (See page 52)

13. We recommend that investment dealers adopt standards of research coverage that include, at a minimum, the obligation to maintain and publish current financial estimates and recommendations on securities followed, and to revisit such estimates and recommendations within a reasonable time following the release of material information by an issuer or the occurrence of other relevant events. Investment dealers should publish notice of their intention to suspend or discontinue coverage of a company. (See page 53)
14. We recommend that in media interviews analysts being interviewed state, or cause the interviewer to state, conflicts of interest that could affect the analysts' opinions, to the extent feasible and in a general way. (See page 53)
15. We recommend that setting price targets should be part of best practices for research, where possible and with the appropriate disclosure. (See page 54)
16. We recommend that the Investment Dealers Association of Canada require its members, in each research report, to use the specific technical terminology that is required by the relevant industry, professional association or regulatory authority. Where necessary for full understanding a glossary should be included. (See page 54)
17. We recommend that investment dealers make their analysts' research widely available through their websites or by other means for all of their clients whom they have determined are entitled to receive such research; and, in order to ensure fair treatment, to make the analysts' research available to all such clients at the same time. (See page 55)
18. We recommend that the Investment Dealers Association of Canada require its members to state their research dissemination policies on their websites or by other means. (See page 56)

19. We recommend that institutional investors, acting together or individually, use best practices criteria to measure the value added by analysts and, to the extent feasible, use such criteria in allocating commission business. (See page 57)

#### REGISTRATION AND SUPERVISION OF ANALYSTS

20. We recommend that investment dealers require their analyst employees to obtain the Chartered Financial Analyst designation. (See page 57)
21. We recommend that the Investment Dealers Association of Canada require each of its members to appoint a supervisory analyst who will be responsible for approving all research reports and recommendations in advance of publication. (See page 61)
22. We recommend that the Investment Dealers Association of Canada develop proficiency standards for supervisory analysts which mandate attainment of the Chartered Financial Analyst designation and require prior industry experience and self-education. The proficiency requirements should grandfather long-practising supervisory analysts, regardless of formal qualifications. (See page 61)
23. We recommend that the Investment Dealers Association of Canada develop a process of annual certification to ensure that all analysts comply with the AIMR Code of Ethics and Standards of Professional Conduct (or the Canadian equivalent) whether or not they are members of AIMR; and that the process require that both a firm's research department head and chief executive officer (or equivalent — see Recommendation No. 26) certify analyst compliance to the standards. (See page 61)
24. We recommend that the Investment Dealers Association of Canada investigate and if appropriate develop a Canadian Code of Ethics and Standards of Professional Conduct for analysts. (See page 62)

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25. We recommend securities regulators exercise their jurisdiction to require independent analysts and newsletter writers to adhere to the same Code of Ethics and Standards of Professional Conduct as sell-side analysts. (See page 62)

### **The importance of corporate governance to analyst independence**

26. We recommend that the Investment Dealers Association of Canada require each of its members to have the head of the research department, or in small firms where there is no head, then the analyst or analysts, report to the chief executive officer or to another senior officer who is not the head of the investment banking department and who is acceptable to the IDA. (See page 63)

27. We recommend that the stock exchanges and the Investment Dealers Association of Canada prohibit members and participating organizations and their employees from establishing, increasing, decreasing or liquidating a position in a listed security, or a derivative security based principally on a listed security, based on knowledge of or in anticipation of the dissemination of a research report, a new recommendation or a change in a recommendation relating to that security by that member or participating organization that could reasonably be expected to have an effect on the price of the security. (See page 66)

28. In firms that do not prohibit analysts from owning securities they cover, we recommend that analysts be required to obtain approval from their supervisor prior to executing any trades in securities of companies that they cover. We further recommend that, in the absence of special circumstances, approval to trade contrary to an analyst's current recommendation should be withheld. (See page 66)

29. We recommend that the Investment Dealers Association of Canada require its members to develop, establish and enforce conflict of interest policies that adequately address the conflicts of interest faced by analysts within their firms. (See page 67)

30. We endorse By-law No. 38 passed by the Board of Directors of the Investment Dealers Association of Canada on October 18, 2000, which requires every IDA member to "designate its Chief Executive Officer, its President, its Chief Operating Officer or its Chief Financial Officer (or such other officer designated with the equivalent supervisory and decision-making responsibility) to act as the Ultimate Designated Person (the "UDP") who shall be responsible to the applicable self-regulatory organization for the conduct of the firm and the supervision of its employees." (See page 68)

31. We recommend that the Joint Committee on Corporate Governance (the Saucier Committee) consider, as part of the corporate governance responsibility of a public company's board, the need for the development and review of a communications policy that addresses how the company's management interacts with analysts and the public, and how the company avoids selective disclosure. (See page 70)

32. We recommend that public companies include the media and investors in analyst meetings and conference calls, thereby avoiding the risk of selective disclosure. (See page 71)

### **The importance of education in the marketplace**

33. We recommend that securities regulators and the self-regulatory organizations work together to foster an understanding of research analysis, analyst recommendations and the role of analysts in the securities industry by providing education to investors and the public within existing educational programs. (See page 71)



## PREFACE

### ESTABLISHMENT OF THE COMMITTEE

The Securities Industry Committee on Analyst Standards was established in September 1999 by the Toronto Stock Exchange, the Investment Dealers Association of Canada and the predecessors of the Canadian Venture Exchange in response to the many questions and concerns which have been raised about the role that analysts play in promoting stocks in the marketplace. An ongoing public discussion both in the press and in two high profile securities industry reports<sup>1</sup> has raised concerns about the influence analysts have, both in the capital marketplace and over the retail investor. The question is also being asked, “Are the potential conflicts of interest between analysts and their employers being managed in the best interests of investors?”

The Mining Standards Task Force, which reviewed the standards and disclosure practices of the Canadian public mineral exploration and mining industry, recommended that a securities industry committee be established to review analysts’ practices. The Task Force encouraged a general review of analysts’ activities in response to the many presentations and submissions it received that leveled sharp criticism at the role played by mining analysts in promoting mining stocks. The Interim Report released in June 1998 by the Task Force made one recommendation concerning analyst standards and received extensive

<sup>1</sup> *Report of the Joint Securities Industry Committee on Conflicts of Interest (the Hagg Report), September 1997; and Setting New Standards: Mining Standards Task Force Final Report, January 1999.*

## PREFACE

“We recommend that Canadian self-regulatory organizations form an industry committee to examine the standards of supervision of analysts’ activities.”

(Mining Standards Task Force, 1999)

criticism on the need for additional recommendations. The Task Force’s Final Report was released in January 1999 and contained 66 recommendations, eight of which were directed specifically at analyst practices.

The key Mining Standards Task Force recommendation concerning the establishment of the analyst committee is:

We recommend that Canadian self-regulatory organizations form an industry committee to examine the standards of supervision of analysts’ activities and interpretations of the Association for Investment Management and Research’s Code of Ethics and Standards of Professional Conduct, with the objective of establishing minimum industry standards governing the supervision and conduct of all research analysts.

The full list of recommendations contained in the Mining Standards Task Force which are relevant to this report are listed in Appendix III.

### ANALYST COMMITTEE MANDATE

The mandate for the Committee includes:

1. Review the practices and activities of securities research analysts in Canada;
2. Review the standards of conduct and supervision of analysts; and
3. Report on securities industry standards governing the conduct and supervision of analysts, and make appropriate recommendations regarding the conduct and supervision of analysts to preserve the integrity of the capital markets.

The Committee’s objective was to look at the existing practices in the marketplace and at the concerns raised in submissions and presentations, and then to craft recommendations to strike the right balance between providing protection to investors and fostering fair and efficient capital markets and confidence in capital markets. Wherever possible the Committee has attempted to draft detailed recommendations directed towards specific organizations, to ensure that the actions required and the responsible parties are clearly identified to assist in implementation.

During the Committee’s deliberations the SEC introduced its new fair disclosure regulation (Regulation FD) which specifically addresses the way that US publicly reporting companies must now interact with the public, including analysts and brokerage firms. The public discussion

of the pros and cons of Regulation FD is a fortunate coincidence and has provided the Committee with a broader viewpoint than that of the Canadian marketplace alone and underscores that the issue the Committee is grappling with is of concern in other jurisdictions as well.

#### PROCESS OF THE ANALYST COMMITTEE

The Committee membership is drawn from different sectors of the securities industry, and includes representatives of investment dealers, institutional investors, listed companies and self-regulatory organizations. The Committee represents all of the securities industry SROs except for the Bourse de Montréal which was undergoing a restructuring when the Committee was established. An observer from the Canadian Securities Administrators also took part in the meetings.

The knowledge base of the Committee members and those who delivered submissions and representations resulted in balanced and in-depth discussions. Investor interests and the investor protection mandates of the regulators represented in the discussions were paramount in the deliberations.

The Committee solicited submissions from the public by placing notices in SRO publications and by advertising in major Canadian newspapers. The Committee met 15 times from October 1999 through February 2001 to hear presentations, discuss the submissions, consider the issues, and to arrive at the conclusions and recommendations set out in the Draft Report; and met twice from August through October 2001 to discuss comments received on the Draft Report and formulate the Final Report.

#### COMMENTS RECEIVED ON THE DRAFT REPORT

The Draft Report was issued in April 2001. In response to the request for comments on the Draft Report, the Committee received 28 letters, from companies, associations and individuals. The comments were considered carefully by the Committee in preparing the Final Report, and as a result several recommendations were amended, and five recommendations were added.

In general the commentators supported the Committee's decision to focus attention on the practices of research analysts in the public marketplace. Most respondents offered support for the thrust and recommendations of the report, but focused their commentary on only the key issues with which they either emphatically agreed or disagreed.

Investor interests were paramount in the deliberations.

## PREFACE

Analysts have to balance significant conflicts of interest in their positions.

There is an important need to ensure that any regulatory response to the report does not erect new borders in the financial world.

<sup>2</sup> The Pro Group includes both individually and as a group, the member firm (of a self-regulatory organization), employees of the member and partners, directors and officers of the member and their associates and affiliates, as defined in proposed IDA By-law 29.15(a) and TSE Section 1.01. The rules grant the SROS the discretion to exclude a party from the Pro Group if it is determined that the party is acting at arm's length of the member; as well as the discretion to include a party in the Pro Group where that party is not acting at arm's length of the member.

Most of the letters agreed that:

- Analysts have to balance significant conflicts of interest in their positions.
- Many of the most serious conflicts affect analysts in sell-side firms that do significant corporate finance work and trading.
- Conflicts need to be mitigated in some way.
- Mandatory policies in firms to reduce conflicts are a good idea.
- Some means of registration of analysts is a good idea.
- Disclosure of any conflicts of interest is important and necessary for investors to understand the relevance of published research.
- The AIMR standards are a good idea.

Several common concerns also emerged from the comment letters, including the following:

- There is an important need to ensure that any regulatory response to the report does not erect new borders in the financial world.
- Analyst registration does not solve all conflicts and the cost is high.
- New regulations will only add costs and not help investors.
- Investors will not read the new mandated disclosure.
- The Chartered Financial Analyst designation does not ensure a good research product but adherence to the CFA's required standards does.
- The definition of the Pro Group<sup>2</sup> is too broad.
- Care should be taken in mandating research standards, as budgets will be reduced if research does not give a firm competitive advantage.

In addition, suggestions for other recommendations were made for the Committee to consider. These included the mandatory registration of all analysts, the need to engage institutional investors in driving the quality of research and the proposal that Canada should follow what has been done in the US. All comments were carefully considered.

The names of the organizations, companies and individuals that provided valuable information and proposals to the Committee are set out in Appendices I and II. Comments on the Draft Report can be viewed through the TSE website at [tse.com](http://tse.com). We wish to thank all who took the time to make submissions, presentations and comments. Their input has directed our review and provided the public perspective for our deliberations.

#### OPTIONS CONSIDERED BY THE COMMITTEE

The Committee identified a range of potential remedies for all of the problems or concerns raised, which included disclosure, registration, regulation, and prohibitions. The Committee's approach was to identify the problems not addressed by existing rules, regulations or policies, and to recommend a remedy sufficient to address the problem while attempting to minimize the regulatory burden.

Several options were considered for each issue including:

- Making no change and leaving it to the market to adjust. For some issues it was felt that the market was already adjusting and that, over time, the issues would be addressed by ongoing regulatory or business change.
- Requiring some additional disclosure. Although we believe that the market adjusts to some conflicts, we believe that some situations may call for a regulatory response mandating certain disclosure.
- Mandating specific standards of practice applicable to analysts.
- Extending to analysts the registration regime that exists for other investment professionals. This would allow direct supervision and the implementation and enforcement of standards by the regulators.
- Imposing certain restrictions on analyst and brokerage firm practices, to protect the investor from conflicts of interest that may impact research recommendations without investor knowledge; and
- Enacting specific prohibitions for analyst practices in situations that cannot be rectified by any of the less intrusive regulatory responses.

The Committee's approach was to identify the problems not addressed by existing rules, regulations or policies.



## 1.0 INTRODUCTION

The role of the analyst is of fundamental importance in the relationship between companies and investors.

### 1.10 BACKGROUND

The role of the analyst is of fundamental importance in the relationship between companies and investors. The securities industry employs analysts to assess publicly disclosed information for its clients, who include both retail and institutional investors. It is important to note that the role of the analyst extends far beyond relaying information released by a company. The analyst interprets this information in the light of industry trends, international developments, competitor activities, management capabilities and market conditions. Analysts also try to predict the value of a security into the future.

The analyses and opinions of analysts are important both to the companies that they are following and to the investors who use their opinions to help formulate their investment decisions.

Some problems raised in submissions and presentations to the Committee or identified by the Committee can be illustrated by the examples below. These examples highlight practices that prompted the establishment of this Committee.

- Dealer principals and brokers employed by dealer firms have been known to take control of a listed company and promote its stock,

in part through buy recommendations by analysts employed by the dealers without disclosing these conflicts of interest to other investors.

- Dealers have formed junior companies and have acquired shares at very low prices, prior to taking the companies public and acquiring additional shares in lieu of underwriting fees. The dealers' own analysts have then recommended stocks to clients in research reports without disclosing the conflicts of interest that exist within the firm.
- Some analysts have gone beyond the bounds of good practice in analysis and forecasting companies' earnings and have become company promoters rather than market analysts.
- Analysts, whose firms have underwritten companies' issuance of securities and who remain active in trading these securities, have not disclosed these conflicts of interest and have continued to produce positive research even as the stock prices have fallen and the companies have moved towards bankruptcy.
- The practice of analysts discontinuing research on a stock when the price falls, rather than downgrading a previous recommendation, and not informing investors of the discontinuance.
- Dealers sometimes appear to have built up their inventory in stocks prior to their own analysts releasing a significant buy recommendation and then, following release of the recommendation, have sold the stock to their clients at a profit.
- Companies have paid analysts for publishing positive research coverage, without any disclosure to the reader of the "for payment" relationship between the analyst and the company.
- Companies have retained dealers for stock distributions based in part upon the promise of continuing positive research coverage after the distribution.
- Institutional investors, who are very important clients for dealer firms, have been known to exert pressure on analysts not to change previous recommendations.

#### **I.20 FUNDAMENTAL PRINCIPLES OF THE STOCK MARKET**

Maintenance of market integrity is essential to the competitiveness of Canada's markets and the ability of companies to raise capital. Markets that inspire investor confidence attract higher trading volumes, which lead to greater liquidity, which in turn attracts more trading.

Maintenance of market integrity is essential to the competitiveness of Canada's markets.

## INTRODUCTION

The Canadian capital market is governed by a disclosure-based regulatory regime.

The market is regulated for investor protection.

Robust markets lower the cost of capital and result in more investment activity in Canada.

### The Market

The major participants in the stock market are public companies, the stock exchanges, investment dealers, investors and regulatory authorities such as the securities commissions and the stock exchanges.

The Canadian capital market is governed by a disclosure-based regulatory regime. Companies that want access to financing in the public marketplace must disclose all material information to the market. Securities laws require reporting issuers to disclose material information about their business to investors and to the marketplace in general. Securities laws also mandate that companies must regularly release financial and other information to ensure that all investors are aware of the status of the company's activities. This information should be released so that it is available to all investors at the same time. Securities laws prohibit selective disclosure of material information.

The market is regulated for investor protection. In Canada, provincial securities commissions regulate trading in securities. The exchanges operate as both stock markets and SROs that regulate trading and in some cases dealers' trade-related activities. Investment dealers gain access to the securities markets through registration that is administered by the IDA in most of Canada and by the Bourse de Montréal in Québec. These two SROs are responsible for the regulation of dealers' activities, other than trading, including their relations with clients and the maintenance of capital adequacy. The securities commissions retain oversight of regulation by the SROs and monitor and enforce the provisions of the various securities acts.

### Information in the Market

The securities industry exists on information. Stock prices are affected by information on companies' performance and potential, and by the analysis of that information. Investors obtain their information from many sources, such as company-prepared annual and quarterly reports and financial statements, news releases, broker recommendations, analyst research and recommendations, newspapers, broadcast news, financial newsletters, company and investment websites, and through the long-standing medium of market gossip.

Analysts use all of this information and then combine it with other pertinent information to prepare an analysis to value the shares or the prospects of a company. This analysis is very useful in helping investors understand both the potential value of the company and the effect that changes in the market may have on this value.

Investors may rely on all of the information in the marketplace to make investment decisions. Since analysts' reports often present the company's results along with perceptive analysis, and compare the results to those of key competitors, these reports are often regarded as a valuable source of additional information that helps the investor make informed decisions.

Retail investors and small institutional investors obtain their information from the many different sources previously listed. Many investors read analyst reports and use the analysts' recommendations to help guide their investment decisions. Retail and small institutional investors cannot be characterized as one homogeneous unit and they vary widely in investment knowledge. However, they often do not have the breadth of knowledge or perspective that their brokerage firm can offer through analytical reports. They are also more likely to view analysts' reports as more objective than information that comes directly from the issuer.

Institutional investors on the other hand are quite different in their need for research and analysis. Institutional investors, including mutual funds, pension funds and insurance companies, often employ their own professional staff to evaluate and augment public company information. These investors do not for the most part rely as heavily on sell-side analyst recommendations to guide their decisions as retail investors do, but rather use sell-side reports as part of the information to study.

It was clear during our deliberations that retail investors are more in need of the protection of the regulatory regime than more sophisticated investors who have the resources to conduct independent research. The Committee has therefore focused its efforts on recommending changes that are required for the good of the market and that would in particular assist retail and small institutional investors.

#### **The Role of Public Companies in the Market**

By raising capital from the investing public, companies assume obligations to shareholders and investors that are formalized in securities laws. One such obligation is to disclose material information to the market promptly. Public companies have an obligation to disseminate this information widely through approved newswires or otherwise to all investors. Increasingly, they also post this information on the Internet. If a company releases material information selectively, it provides unfair advantages to those who have the information and thus violates securities laws. The market relies on public companies to adhere to the law and release material information to the entire market at one time.

Investors may rely on all of the information in the marketplace to make investment decisions.

The Committee focused its efforts on recommending changes that are required for the good of the market.

The market relies on public companies to adhere to the law and release material information to the entire market at one time.

## INTRODUCTION

Canadian public companies also have an obligation, upon the occurrence of a material change, to file a material change report with provincial securities regulatory authorities and to issue a news release.

The Canadian requirement means that information relating to a material change is theoretically available to all investors and reduces the opportunities for an analyst to obtain material information from a company prior to its public release. We use the word “theoretically” because it is our impression that, at least until recently, practices in Canada relating to selective disclosure have been similar to the United States. The practice of selectively disclosing material information to analysts in the US was addressed recently when the SEC implemented Regulation Fair Disclosure (Regulation FD). The import of Regulation FD is to provide that, where a public company makes a disclosure of material non-public information to certain classes of persons, the issuer must concurrently for intentional disclosure, and within 24 hours for unintentional disclosure, make public disclosure of the same material information. It is important to note that, unlike the situation in Canada, Regulation FD does not require public companies to make full public disclosure of all material developments when they occur; however, if and when such disclosure is made, it must be made broadly and may not be made on a selective basis.

In its release of Regulation FD, the SEC expressed concern that “if corporate managers are permitted to treat material information as a commodity that can be parceled out selectively, they may delay general public disclosure so that they can selectively disclose the information to curry favor or bolster credibility with particular analysts or institutional investors.”

The SEC further noted:

“We are greatly concerned by reports indicating a trend toward less independent research and analysis as a basis for analysts’ advice, and a correspondingly greater dependence by analysts on access to corporate insiders to provide guidance and ‘comfort’ for their earnings forecasts.

In this environment, analysts are likely to feel pressured to report favorably about particular issuers to avoid being ‘cut off’ from access to the flow of non-public information through future analyst conference calls or other means of selective disclosure. This in turn raises concerns about the degree to which analysts may be pressured to share their analysis in order to maintain their access to corporate management.”

“We are greatly concerned by reports indicating a trend toward less independent research.”

(SEC)

We understand that the Canadian Securities Administrators (CSA) intends to publish guidelines relating to selective disclosure. Much greater public awareness of this issue should over time result in substantially ending selective disclosure. We regard this as a very positive development towards strengthening the independence of analysts. In this connection we are in agreement in substance with the comment of the SEC quoted above.

### Investment Dealers in the Market

Securities laws require all persons or companies who trade<sup>3</sup> in securities to be either registered or exempted from registration as dealers. Investment dealers are firms that are registered to trade in securities and that act as agent or principal in primary market distributions and in secondary market trading as well as investing their own capital in the market. Investment dealers are members of the IDA<sup>4</sup> and many are also members or participating organizations of stock exchanges. As members or participants of these SROs, they are governed by the rules of each of the SROs to which they belong. They are also subject to the provincial securities laws that apply to all registered dealers.

Dealers are all organized somewhat differently but generally share the following functions (regardless of what the functions are named within the firm):

- corporate finance operates in the primary market with public company clients making initial public offerings and additional distributions to investor clients and also in mergers and acquisitions;
- institutional trading deals with institutional clients and assists in minimizing the market impact of buying and selling large blocks of stocks;
- proprietary trading involves trading for the firm's own account with a view to profit as well as with clients to facilitate the latter's need to buy or sell;
- retail deals with retail clients, advising on investments and processing orders;
- research employs analysts to research and analyze information about companies and industries and provides the analysts' reports and recommendations to the rest of the firm for distribution to clients through the other parts of the firm that deal with clients; research also works with corporate finance, institutional sales and trading and institutional investors;

Securities laws require all persons or companies who trade in securities to be either registered or exempted from registration.

<sup>3</sup> "Trade" is defined as a sale, but not a purchase, of a security. Investors who sell securities are exempted from registration as dealers because they are trading through a registrant; the term is widely interpreted as applying to those who are in the business of trading in securities.

<sup>4</sup> Except in Quebec.

## INTRODUCTION

Securities regulatory authorities try to co-ordinate regulation through the Canadian Securities Administrators.

Dissemination of an analyst report to clients would fall under IDA jurisdiction while trading ahead of dissemination of the report would fall under stock exchange jurisdiction.

There is little in the current securities rules that applies directly to analysts.

- compliance works with the entire firm, educating about and interpreting applicable laws and SRO rules to assist the firm and its employees in complying with them.

### Regulation in the Market

Securities regulation in Canada is the responsibility of provincial and territorial securities regulators as there is no federal regulator. Securities regulatory authorities try to co-ordinate regulation through the Canadian Securities Administrators, to attain national consistency. We note with approval recent changes in the funding of securities commissions in Ontario and Alberta, which has enabled the commissions to retain more staff and devote more resources to enforcement of securities laws. It must be noted that it is only with adequate enforcement that the level of compliance with the laws improves.

Market participants, including dealers, stock exchanges and public companies whose shares are sold to investors and traded in the secondary market, are governed by securities legislation that is administered by the securities regulatory authorities. They in turn oversee dealer regulation by the IDA and market regulation by the stock exchanges. The IDA and the stock exchanges enact their own by-laws and rules that supplement provincial securities laws governing dealer and market activity. The IDA regulates member compliance with capital requirements and member relations with their clients. The stock exchanges regulate trading activity. In some areas, the regulatory roles may overlap. For example, dissemination of an analyst report to clients would fall under IDA jurisdiction while trading ahead of dissemination of the report would fall under stock exchange jurisdiction. The SROs attempt to co-ordinate their rulemaking in the overlapping areas.

The IDA and the stock exchanges mandate supervisory responsibilities that investment dealers must carry out with respect to their employees. The CEOs and senior management of these firms are responsible for ensuring that their employees conduct their business in compliance with securities laws and SRO rules. These officers are also responsible for maintaining and enforcing high ethical standards for the good of the firm and the securities industry.

There is little in the current securities rules that applies directly to analysts. Analysts are subject to the same rules and policies that other dealer employees are subject to, but analysts are not required to be registered. Outside of the supervision of the dealer firms, or being registered as directors or associates, analysts are not regulated as such. Generally, there is no legal relationship between an analyst and an investor. It may be argued that the analyst, or the analyst's firm, owes a fiduciary duty to those investors who reasonably rely upon the

analyst's research materials, but determining whether a given relationship is fiduciary is difficult and depends on the specific circumstances.

Investment dealers have followed the practice of implementing their own internal policies and compliance procedures for securities regulations governing their business activities. These policies may set more stringent specific rules than prevailing securities regulations and self-regulatory rules to promote a higher standard of business conduct. As well, many firms have established formal procedures for compliance with existing rules, particularly complex regulations such as the confidentiality requirements in provincial statutes.

We have been impressed with the internal policies and compliance guidelines in place at some securities firms. However, we have also concluded that these internal policies and guidelines can vary significantly across firms in the securities industry, with some firms adopting a more comprehensive approach than their competitors. In our view, regulators should encourage all registered securities firms to implement internal policies and procedures to ensure full compliance with existing securities regulation and a high standard of business conduct.

Since the Draft Report was published, it has become evident that others share the Committee's concerns. The Securities Industry Association in the US, which has nearly 700 securities firms as members, produced *Best Practices for Research*. Developed by the SIA's Ad Hoc Committee on Analyst Integrity, the booklet provides guidelines for the integrity of research, the research process, and conflicts of interest. The Committee lauds the development of these guidelines and recommends that the document be studied by the IDA in the implementation of some of this report's recommendations. We do wish to note that while the guidelines are important, they are not mandatory.

At this time NASD Regulation, Inc. has requested comment on a proposed amendment to NASD Rule 2210, which would strengthen disclosure required when a member recommends a security in written advertisements and sales literature. The proposed amendment would also require, for the first time, similar disclosures for recommendations made by a research analyst or other associated person during a public appearance. The proposal defines public appearance to include participation in a seminar, forum (including an interactive electronic forum) and radio or television interview. We are pleased to see that this proposed rule would mandate some disclosure. Harvey Pitt, the Chairman of the SEC, supports and encourages this development by NASD. The SEC have stated that they believe these issues are not legal ones but ethical issues that are best policed by SROs.

Internal policies and guidelines can vary significantly across firms in the securities industry.

AIMR also published, as the first of three initiatives to address the issue of analyst independence, a position paper entitled *Preserving the Integrity of Research*. The second initiative is the development and publication of the AIMR Research Objectivity Standards, which will establish specific, measurable, best practices to manage and disclose conflicts of interest. The third initiative will be a topical study providing additional guidance in applying the current requirements of AIMR's Code of Ethics and Standards of Professional Conduct to issues of concern.

#### **Changing Economics and the Effect on Investment Dealers**

Since the 1970s, the economics of the securities industry have altered dramatically. In the 1970s, trading commissions were still fixed and were a key source of dealer revenue. At that time research departments were supported by revenue from trading fees and preferred clients were provided with research reports to aid in their decision-making. The main clients to receive this information were a firm's institutional clients. In the United States trading commissions were deregulated in 1975 and immediately dealer firm revenues attributable to trading fees dropped substantially. In 1983, the TSE also ended fixed commissions. Institutional clients were able to negotiate lower commissions almost immediately, while retail investors did not benefit fully until the advent of discount brokers in the 1990s.

Research departments play a larger role in marketing the firm and bringing in new business.

In a number of firms over the last 25 years, revenues from investment banking, such as the underwriting of public offerings or merger and acquisition activities have grown significantly relative to commissions from secondary market trading. With this change in revenue sources for investment dealer firms research departments play a larger role in marketing the firm and bringing in new business. Research analysts are now, in part, compensated by the business that they bring into the firm and research coverage is part of the product differentiation used to promote a dealer firm's corporate finance activities. It is clear that analysts have more direct investor contact than they did 25 years ago. This change has placed additional pressures on analysts and added to the conflicts of interest that they face as sell-side analysts.



## 2.0 ANALYSTS

### 2.10 THE ROLE OF THE ANALYST

The generic term “analyst” applies to several different functions within the securities industry. Analysts working at full-service investment dealers are typically referred to as sell-side analysts, while those employed by institutional investors are on the buy-side. Other analysts selling their research on a subscription or other basis are often classified as independent. While many of the Committee’s recommendations apply to all analysts, the Committee’s report focuses principally on sell-side analysts, because of their potential influence on retail and small institutional investors.

In executing its mandate, the Committee reviewed the role of sell-side analysts in detail. This review was considered a crucial step in order to provide relevant context for the Committee’s investigations into conflicts of interest and other pressures bearing upon analysts’ behavior. The Committee concluded that most sell-side analysts play a multifaceted role for their firms. In general terms, analysts in a full-service investment dealer contribute to two principal sources of revenue, commission-related (trading) revenue and investment banking revenue. Analysts support trading revenue by generating investment ideas for clients of the firm. Subject to the dealer’s business model, these clients

## ANALYSTS

Conflicts arise between an analyst's duty to provide independent, objective, advice to investor clients and pressures to support investment banking revenues.

could include retail as well as institutional investors. In either event, analysts consider publicly-disclosed information together with information they derive from their own sources, all of which they interpret in light of their experience and insights to generate performance estimates for a company and, ultimately, a valuation and recommendation on the company's securities. Individual company analysis is generally presented on a relative basis; that is, including other comparable companies in a sector and within the context of industry trends, macroeconomic factors, commodity price forecasts, and so on. This analysis and opinion is communicated to clients in different forms, i.e., written and verbal, and may involve an intermediary sales force.

With respect to investment banking revenue, analysts can play a role in securing transaction mandates for their firms as well as executing these mandates. Analysts can help their firms secure mandates in several ways. They may suggest feasible transactions for their investment banking colleagues to pursue and corporations may award mandates to dealers based on the reputation and stature of the analyst. In terms of executing transactions, analysts are often involved in road shows or other marketing activities organized to communicate the analysts' views to institutional investors.

The potential size of investment banking fees, combined with other trends in Canadian capital markets over the past several years, such as shrinking trading commissions and increased foreign competition, has increased the relative importance of banking revenues to most investment dealers. Consequently, the role of sell-side analysts in support of these revenues has also increased in importance. This has heightened the potential for conflicts arising between an analyst's duty to provide independent, objective, advice to investor clients and pressures to support investment banking revenues through services to the firm's corporate clients.

### 2.20 PRESSURES AND CONFLICTS FACED BY SELL-SIDE ANALYSTS

In this climate of strong competition, analysts face a number of financial, competitive and ethical pressures due to their central position in the investment industry and because of the influence that they can exert on investors. These pressures can include pressures to issue positive recommendations, pressures to publish first, and pressures to get confidential information from a company. Some examples of difficult situations, which have been identified either in submissions or in the press, are:

- Analysts try to meet the demand for unique perspectives and better information about a company or sector compared to their competitors by pressuring companies to release new information to them.
- Companies, directly or indirectly, pressure analysts to be positive and not to disclose the problems discovered during the analysis. They complain about an analyst's report or ostracize an analyst in retaliation for a low rating or the downgrading of a research recommendation.
- Dealer firms' corporate finance departments pressure analysts to cover their finance deals with positive research, even though it may put them in a conflict. Analysts are expected to support the corporate finance activities of their employers, which may include promoting stocks distributed by the dealer.
- Institutional or buy-side investors pressure analysts to discuss their analysis with them on a priority basis.
- Institutional investors have been known to pressure analysts not to change their opinions and recommendations in cases where a change may impact the institutional investors' financial results.
- The remuneration system now in place for many sell-side analysts pressures some into continued positive coverage even for poorly performing companies, since there are substantial financial rewards for bringing business to the corporate finance side of the dealer and for contributing to the retention of that business.

In this report it is important to note that the words "conflict" or "conflicts" refer to a conflict of interest or conflicts of interest, unless otherwise noted. Conflicts of interest may be potential, perceived or real, but for the purposes of this report the Committee addresses them all as conflicts of interest.

In the course of their business, investment dealers and therefore analysts face many real and potential conflicts. Investment dealer firms can:

- act as agent for both the buyer and the seller in a stock trade;
- buy from and sell to their clients as principal;
- act on behalf of companies in initial public offerings, distributions, take-over bids, mergers and acquisitions;
- act as venture capitalists and then take the company public;
- recommend that their clients buy, sell or hold particular stocks based on their analysts' reports;
- manage portfolios with discretionary authority; and
- maintain working relationships with institutional investors.

Analysts face many real and potential conflicts.

## ANALYSTS

Good compliance requires management support and example.

The market now perceives that sell-side and some independent analysts are in an ongoing situation of conflict.

<sup>5</sup> “Conflict of Interest and the Credibility of Underwriter Analysis Recommendations” by Ron Michaely and Kent L. Womack, *The Review of Financial Studies*, Special 1999 Vol. 12, No. 4.

Given the range of activities undertaken, it is often difficult for the firm to manage the variety of conflicts that do exist. It is in part because of these conflicts that the securities industry is so highly regulated.

Each dealer must have policies in place to ensure that it complies with all the legal and regulatory requirements and to maintain an ethical standard of behavior in the market. In most firms compliance issues are taken very seriously and the compliance staff are vigilant. However, there are examples of compliance procedures not being enforced or adhered to and some serious incidents that have been the subject of regulatory proceedings and litigation in the past few years.

Compliance is an important issue for dealer firms. Good compliance requires management support and example. The board of directors and chief executive officer of a firm are responsible for creating a culture in which ethical practices are encouraged and rewarded.

Reliance on management to set the tone and follow through cannot alone protect the reputation of the industry because of the range of recommended that some issues require prohibitions of certain conflicts and mandatory disclosure of other conflicts.

Some of the comments received on the Draft Report noted that while much of the report focuses on sell-side analysts there should be no doubt that many of the conflicts can also exist for buy-side analysts. There is no question that many analysts are faced with some conflicts. However, we have chosen to focus on the activities or conflicts that could impact retail and small institutional investors.

### 2.30 MARKET PERCEPTION OF ANALYSTS

Over the past few years several incidents have drawn attention to analysts and the important role they play in the market. News articles, academic and public studies and presentations to the Committee all discuss the significant conflicts of interest that analysts and dealers face and the effect of these conflicts on the integrity of the market. The market now perceives that sell-side and some independent analysts are in an ongoing situation of conflict that must be addressed by changes in practice.

For example, an academic study in the US concludes that underwriter analyst recommendations show significant evidence of bias and suggests that there is a potential conflict of interest inherent in the different functions that investment bankers perform.<sup>5</sup>

We are aware that there is a fine line between promotional coverage and balanced analytical coverage of a company. While most analysts write balanced analytical reports, some analysts do write strong promotional material for the benefit of either dealers or public companies. The problem with the current practice in the marketplace is that retail investors often cannot tell the difference between well-balanced research material and material that is promotional.

Press coverage also highlights conflict-related issues, especially with respect to the preponderance of buy recommendations by sell-side analysts. The proportion of buy recommendations has increased dramatically over the years. A study undertaken in the US in October 1999, a time when the market was overvalued, found that more than 70% of all recommendations are buy recommendations and only 1% of all recommendations are sell.<sup>6</sup> In Canada, research based on Bloomberg consensus ratings indicates that since 1998 the Canadian “sell recommendation rate” is approximately 4%, higher than the US rate. Those staggering statistics may be explained by the optimism of the long bull market or as a result of the propensity of analysts to cover only companies that they like. The high percentage of buy and hold recommendations may also be explained by pressure on analysts to support the core business of their dealer employers. In a speech made in October 1999, Arthur Levitt, chairman of the SEC, stated that:

“analysts all too often are falling off the tightrope on the side of protecting the business relationship at the cost of fair analysis.”

The scarcity of the sell recommendation is perhaps the clearest signal of the conflicts that affect research within sell-side firms.<sup>7</sup>

It is also of interest to note that the recent Reuters Canada 2000 Survey<sup>8</sup> indicated that analysts believe that the companies they follow would react very negatively to a sell recommendation. It comments:

“Some 92% of analysts expect corporations to react to the publication of a sell recommendation and think that being excluded from financings will be the most likely outcome. By contrast, only 50% of corporations say that they would actually react to a sell recommendation at all.”

The survey concludes that:

“Regardless of whether corporations actually react or not, if analysts believe so strongly they will be excluded from financings as a result of a sell recommendation, they are likely to be reluctant to publish them.”

Some 92% of analysts expect corporations to react to the publication of a sell recommendation by being excluded from financings.

<sup>6</sup> First Call/Thomson Financial survey of 27,700 individual stock recommendations by analysts, October 1999.

<sup>7</sup> “Let the buyer beware” by Andrew Hill, *Financial Times*, October 27, 1999.

<sup>8</sup> *The 2000 Reuters Survey of Canadian Company Investment Research, Sales & Trading, Investment Banking*, 2000.

## ANALYSTS

Many retail investors still believe that analysts should generate completely independent research.

Recent articles in the US press relate how analysts have used new yardsticks to forecast value for new economy companies during the digital tech boom. One analyst looked at cash burn rates and ranked a group of Internet retailers into three tiers according to the projected odds of survival.<sup>9</sup> Another analyst, who had abandoned the traditional price/earnings ratio form of evaluation, was quoted as saying:

“If investors want to be in these high-growth companies, we are just trying to take what they are willing to pay and translate it into a target price and therefore a stock recommendation.”<sup>10</sup>

Yet another maintained that Internet stocks adhere to a mathematical valuation system so rigid it resembles patterns found in nature. He looked at their valuation relative to one another by plotting their market capitalization rank on a logarithmic chart.<sup>11</sup> The issue with these new valuation methods is that they are often not understood or tested and they have been used by some firms to promote stocks rather than analyze the value of the companies for the benefit of investors.

Many retail investors still believe that analysts should generate completely independent research and free themselves of the firm’s conflicts. For the majority of analysts that is not possible, given the conflicting needs of their clients and employers. There is ample evidence that sell-side analysts now operate in a constant atmosphere of pressure and conflict of interest. Some succumb to the pressures, issuing positive reports on stocks rather than risk being shut out by the companies they cover, or offending management of their own firms and damaging their career prospects.

“It’s a balancing act ... On the one hand, analysts want to keep management, investment bankers and clients happy. But they also need credibility, or what they write will have no impact. The ones who survive with reputations intact are those who know how to tell the truth — and still get the deal sold.”<sup>12</sup>

The Committee recognizes that market forces provide incentives for investment dealers and analysts to act fairly and credibly in balancing the potentially conflicting demands of their institutional and retail customers and corporate clients. Specifically, analysts and investment dealers understand that investors will ultimately recognize biased and untrustworthy advice and, as this opinion takes root in the financial community, it will undermine trading and investment banking revenues.

<sup>9</sup> “Goldman Raises Some Eyebrows with E-Commerce Winners List,” *Wall Street Journal*, June 20, 2000.

<sup>10</sup> “Analysts Twist Their Yardsticks to Justify P/E Ratio of Cisco & Co.,” *Wall Street Journal*, April 12, 2000. And see “How High is too High for Stocks that Lead a Business Revolution?” *Wall Street Journal*, Jan. 10, 2000.

<sup>11</sup> “Analyst Discovers Order in the Chaos of Huge Valuation for Internet Stocks,” *Wall Street Journal*, December 27, 1999.

<sup>12</sup> “Analysts Who Dare to Tell the Truth,” *The Street.com*, Z. Lundbord, July 4, 2000.

The Committee's review suggests that retail and institutional clients value different components of analysts' work. Specifically, institutional investors tend to emphasize analysis of such factors as a company's growth strategy, operations, competitive position and financial structure, while placing less weight on analysts' performance estimates and valuations. While these investors may value an analyst's recommendation, they generally see the decision whether or not to own a stock as their role and responsibility. Retail investors, on the other hand, appear to rely more extensively upon analysts' price targets and recommendations. Many institutional investors have the opportunity of direct contact with sell-side analysts through telephone calls and face-to-face meetings. These discussions allow the institutional investor to focus the analyst on areas of interest and, as has been suggested, explore opportunities to "read between the lines" of what an analyst has written. The Committee feels strongly that analysts' written opinions and recommendations should stand on their own and accurately disclose the substance of analysts' views. The Committee also believes that investor interests would be served by disclosure of factors that may potentially influence these views.

In making the recommendations set out in this report, we have sought to foster market integrity; to strengthen the ability of analysts to give objective, independent, opinions; and to ensure that where conflicts do exist they are identified and in some cases eliminated.

We have sought to ensure that where conflicts do exist they are identified and in some cases eliminated.



### 3.0 CURRENT SUPERVISION OF ANALYSTS

Securities regulation has not kept pace with the rapid developments in the ease of communications and the scope of trading.

#### 3.10 BACKGROUND

Today, with the advent of the Internet, analytical reports and company disclosure can be made available to all investors and potential investors simultaneously anywhere in the world. Dealers can make their research and recommendations available to all of their clients, regardless of where they are located. This speed and extent of disclosure has had a significant effect on the whole securities industry.

Securities regulation has not kept pace with the rapid developments in the ease of communications and the scope of trading. Securities regulation continues to be tied to national or provincial or state jurisdictions. Securities laws have force only in the jurisdiction in which they were enacted. This restriction affects the ability of regulators to oversee cross-boundary activities, such as commentary in foreign newsletters or the disclosure of information on the Internet.

When any changes to the regulation of a particular aspect of the Canadian securities industry are contemplated, it is clear that the international nature of the securities business must be taken into account. Regulators must avoid making regulation changes that will make it difficult for Canadian dealers to compete outside Canada, or that will disadvantage Canadian analysts or possibly drive them into other jurisdictions. Such results would not effectively change practices

that need to change and would in fact hurt the capital market in Canada. The Committee was very aware of these concerns during its deliberations.

### 3.20 REGULATION OF ANALYSTS

Participants in the securities industry are regulated by provincial securities regulators and by the SROs to which they belong.

Each province has securities legislation that requires individuals and companies that advise or trade to be registered or in some cases exempted from registration for that purpose. This registration requires a thorough understanding of the market and prohibits activities that have been found to be contrary to the public interest. The SROs operate under authority delegated by the provincial regulators. The IDA registers salespersons and traders and regulates the capital adequacy of its members as well as their sales practices. The TSE and CDNX are recognized as stock exchanges and are responsible for market regulation. The Bourse de Montréal carries out both member and market regulation.

The SROs have jurisdiction only over their members and participating organizations. The provincial securities regulatory authorities have jurisdiction over all SRO member dealers, other registered dealers and have public interest jurisdiction over market participants, including unregistered analysts. Those analysts who are not employed by dealers are required to register if their activities are subject to securities legislation in one or more provinces.

The investment dealers that are members of the IDA have supervisory responsibilities over their employees. Those that are also members of the stock exchanges have additional supervisory responsibilities over the trading activities of their employees.

An excellent description of the existing rules and regulations in the self-regulatory system and the provincial statutes can be found in the Hagg Report, known more formally as the *Report of the Joint Securities Industry Committee on Conflicts of Interest*. Section 3.13 of this report, published in September 1997, states:

“Each of the self-regulatory organizations has rules that require partners, directors, officers, managers, brokers and other employees of member firms to observe high standards of ethics and business conduct and to carry out their activities in a manner which is not detrimental to the public interest.”

## CURRENT SUPERVISION OF ANALYSTS

A review of the provincial securities Acts reveals no provisions specifically relating to analysts.

There is little of specific application to analysts in securities legislation or SRO rules at present.

A review of the provincial securities Acts reveals no provisions specifically relating to analysts but the Acts do contain general provisions governing the disclosure of conflicts, a general requirement to deal honestly and fairly with clients and a prohibition on trading on insider information. These provisions are not aimed at analysts specifically but could be applied to sell-side analysts as employees of registered dealers. IDA rules for members govern the objectivity and accuracy of information in sales literature, which includes research reports, but these rules also do not refer specifically to analysts. The stock exchange rules contain provisions governing just and equitable principles of trade and prohibit manipulative or deceptive trading or frontrunning client orders. Once again, these rules do not refer specifically to analysts but apply to them indirectly as employees of the participating organizations of the exchanges. In addition to these general rules, the exchanges have developed specific trading rules but these also do not address the conduct or standards of practice for analysts.

Contravention of securities legislation or SRO rules can lead to enforcement proceedings against a dealer or individual. It is important to note that, in the absence of specific rules governing analysts, any enforcement action due to a problem with an analyst would in most cases be limited to action against the dealer for failure to supervise the analyst. The TSE has the power to sanction employees of its members, but only with respect to trading rules. Dealers and individuals are also subject to legal actions that may be brought by aggrieved clients, as both have a common law fiduciary duty to their clients and may be held liable for breach of fiduciary duty. A common law action for negligent misrepresentation in a research report may also be possible but generally only in extreme circumstances would that be pursued.

After a careful review of the existing rules it is clear that there is little of specific application to analysts in securities legislation or SRO rules at present.

### 3.30 REGULATION OF ANALYSTS BY AIMR

Many securities analysts are members of the Association for Investment Management and Research (AIMR), which is an international non-profit organization based in the United States. Its 46,000 members include 5,800 in Canada. Membership is obtained through study and the successful completion of three comprehensive exams. While membership in AIMR is definitely a coveted certification for most analysts, it is not generally a requirement of employment as an analyst.

AIMR members are subject to the association's Code of Ethics and Standards of Professional Conduct (see Appendix IV), which are designed to ensure fair treatment for clients, and which are promoted through continuing education programs. An annual disclosure filing is mandatory, in which each member must disclose any contravention of professional conduct or departure from AIMR's Code of Ethics and Standards of Professional Conduct during the previous year. Failure to file this annual statement leads to suspension from AIMR and the right to use the Chartered Financial Analyst (CFA) designation is revoked.

The AIMR Code of Ethics and Standards of Professional Conduct offer advice for those occasions when an analyst is making investment recommendations about specific companies and the analyst, or the dealer firm, holds significant investments in those securities. The Standards of Professional Conduct require that the analyst disclose beneficial ownership in all securities that could be reasonably expected to impair the analyst's ability to make objective recommendations. The standards also require that client transactions be given priority over transactions in securities in which the member firm has beneficial ownership.

An AIMR Personal Investing Task Force recommended specific guidelines for analysts and member firms that include the following:

- Investment personnel in member firms should establish adequate review and compliance procedures for governing personal investing activity.
- Analysts are restricted from participating in an initial public offering of equity or equity-related securities.
- Strict limitations should be placed on an analyst acquiring private placements, and appropriate supervision and review procedures should be put in place.
- Analysts purchasing investments should not initiate trades within the same 24-hour period that the firm has a pending buy or sell recommendation in that same security.

AIMR released a proposed issues paper for comment entitled *Preserving the Integrity of Research* on July 10, 2001. This paper is the first of a three-part initiative by AIMR to support independence and objectivity in research reports and recommendations. This first paper identifies and discusses the conflicts of interests and pressures experienced by analysts working for investment banking/brokerage firms that may bias their research reports and recommendations. This initiative illustrates the leadership that AIMR has taken on this important issue and we urge all analysts to read and respond to AIMR's request for comments.

AIMR members are subject to the association's Code of Ethics and Standards of Professional Conduct, which are designed to ensure fair treatment for clients.

**CURRENT SUPERVISION OF ANALYSTS**

We believe that the AIMR code and standards are excellent and we commend AIMR for their development. It is clear, however, that although AIMR has the power to investigate, hold hearings and sanction members, it does not actively police compliance. During its presentation, AIMR advised the Committee that it is an educational association and not a regulator. Adherence to the AIMR Code of Ethics and Standards of Professional Conduct is mandatory for AIMR members but it is not actively enforced.

Analysts must be included specifically in the self-regulatory system to ensure that they can manage their specific conflicts of interest.

**3.40 ASSESSMENT OF THE CURRENT SUPERVISION OF ANALYSTS**

It is clear that there is little in the self-regulatory system that applies specifically to analysts. While analysts are “in” the system, there are few rules that govern their function. We believe that analysts must be included specifically in the self-regulatory system to ensure that they can manage their specific conflicts of interest and that investors can have confidence that all research reports in the marketplace adhere to a minimum standard of disclosure.

Standards without effective enforcement have no real force.

It is also evident that there are no mandated analytical standards currently in place. The existing AIMR standards, while excellent, are voluntary and are not enforced industry-wide. We believe that the AIMR Code of Ethics and Standards of Professional Conduct represent the kind of standards to which analysts should adhere in order for investors to have confidence in the market. We do not believe that continued membership in AIMR without effective discipline is adequate to ensure that analysts adhere to the code and standards. Loss of membership is the sole sanction that AIMR can apply as it can only discipline its members and membership is not a requirement in the industry.

Standards without effective enforcement have no real force. Together with voluntary compliance, they do not do enough to inspire investor confidence. While we believe that the vast majority of AIMR members take the code and standards seriously, compliance with the rules is not actively enforced. We believe that certain mandatory standards are required.



**4.0 KEY ISSUES AND RECOMMENDATIONS**

**4.10 OVERVIEW**

From the submissions and presentations that the Committee received, as well as the comments on the Draft Report, it was clear that there are several significant concerns about how analysts interact with the market and whether or not research reports are biased or give undue advantages to the sell-side firms. Throughout the course of our discussions we heard many comments about the conflicts of interest that analysts face on a daily basis and also about the pressure applied on some analysts by their employers and the companies that they review or research. One presenter called analysts the “ham in the sandwich,” since they are under pressure from two sides to generate positive research.

It was also clear that many of these issues are very complex and cannot be solved in isolation. The practice of analysts cannot be addressed without also commenting on and addressing some necessary changes to dealer firm practice and the need for more coordinated regulation and enforcement of those regulations.

We heard from some dealers and analysts who believe that the issues we have identified are being sufficiently addressed by market forces and that there is no need to review or change the current practice. The Committee does not agree with this position.

There are several significant concerns about how analysts interact with the market.

These issues are very complex and cannot be solved in isolation.

## KEY ISSUES AND RECOMMENDATIONS

Certain practices must change to protect investors.

Several key concerns and issues have emerged that the Committee believes must be addressed by changes both in practice and regulation. The submissions and presentations, and the concerns of some investors that have been followed by the media in Canada and the US, do indicate that there are serious issues. We believe that certain practices must change to protect investors.

The key issues or concerns that the Committee has addressed in the proposed recommendations are outlined below:

- The conflicts of interest that sell-side analysts face due to their employment at dealer firms and which of these conflicts should be disclosed, mitigated through mandatory standards or prohibited;
- The pressure on analysts, subtle or otherwise, by their employer to generate positive research to support the other business of the firm and how that pressure should be handled;
- The new role of the sell-side analyst as an important member of the “marketing team” in dealer firms and how the resulting conflicts can be mitigated;
- The absence of enforceable disclosure standards for research reports;
- The absence of an enforceable code of ethics and standards of professional conduct for analysts, including independent analysts and newsletter writers;
- The practice of selective disclosure to analysts;
- The practice of companies, and institutional investors, pressuring analysts; and
- The failure of some investors to understand fully that analysts are generally not independent and do have to balance varying degrees of conflicts of interest.

The recommendations outlined below address each of these issues. Again, we would like to emphasize that the Committee has tried in most cases to recommend the least intrusive solution for the issues that we considered.

### 4.20 POTENTIAL CONFLICTS OF INTEREST

The public perceptions of analysts and analyst recommendations in some respects diverge from the industry’s perception of itself. Large institutional investors indicated to us that they employ many of their

own analysts to reduce their reliance on sell-side analysts because they believe that the sell-side research is in reality part of the sell-side marketing. Investors maintain that the industry is simultaneously pressuring analysts to promote underwritten stocks while it claims that internal controls adequately protect the investing public from the effects of those pressures. Yet the submissions and presentations to the Committee from the brokerage industry, and discussions with sell-side analysts themselves, suggest there are very few actual conflicts and that research is quite independent and follows stringent supervision and compliance procedures within the firms. This view differs significantly from the public's perception that there is a serious problem.

Both viewpoints cannot be correct. While many firms responsibly handle the conflicts by stringent application of their compliance rules, others do not. We have seen this in several recent scandals in which sell-side analysts recommended the purchase of stock that their own senior management and in some cases the firm itself controlled.

The financial effects of such biased recommendations are not academic. Real investors lose real money. In many cases institutional investors, because of their greater sophistication and financial resources, are better able to evaluate sell-side recommendations and determine if any noticeable or possible bias exists.

There is no question that knowledge of the pertinent conflicts of interest active within a firm or faced by an analyst is important information for all investors using research recommendations. Reliance on biased recommendations can be disastrous for investors. The difficulty of course lies in identifying the best way to address the problem. Dealers maintain that conflicts of interest can continue to be addressed by internal firm supervision, compliance and policies. Based on all of the evidence that has been presented to the Committee, it is obvious that voluntary compliance has not always resolved the conflict of interest and biased research problems.

While we believe that internal controls at some investment dealers do help the situation, they cannot eliminate or reduce the effect of these conflicts of interest industry-wide. All dealers do not have adequate controls, nor do they effectively and uniformly enforce such controls. While internal supervision and compliance do seem to provide analysts with some protection from internal pressures, they cannot protect the analysts in firms where compliance issues are not taken seriously or in situations where the firm itself is severely conflicted. Internal controls can be better, and can be more effectively enforced.

The financial effects of biased recommendations are not academic.

Knowledge of the pertinent conflicts of interest is important information for all investors who use research recommendations.

## KEY ISSUES AND RECOMMENDATIONS

We believe taking the lead is important on this issue, but our response should not be at the risk of severely impacting the Canadian marketplace.

Investors currently are not always presented with the information needed to evaluate bias or even perceived bias in analytical recommendations in the marketplace. We believe that specific industry-wide mandatory rules are needed to ensure that information is available on the inherent conflicts.

In developing its recommendations, the Committee was aware that some might result in difficulties or prove awkward for firms operating both in the US and Canada. It was suggested that the recommendations apply only to Canadian analysts. However, the result of that could be an un-level marketplace given the use of research from outside Canada. Our conclusion is that if the requirements of the home base match or are similar to the Canadian regulations, they will be acceptable. If the requirements are not similar, those firms producing research for a Canadian audience should meet Canadian standards. As one of our commentators suggested, “What is wrong with Canada having higher standards?” We believe taking the lead is important on this issue, but our response should not be at the risk of severely impacting the Canadian marketplace. Wherever possible the Committee has looked to harmonize with practice in other jurisdictions, where it is deemed appropriate, and to recommend practices that will benefit the investors in the market.

Thirty-three recommendations are proposed.

### 4.30 RECOMMENDATIONS

Thirty-three recommendations are proposed to improve analysts’ practice and to ensure investors have key information to assess analysts’ recommendations. The recommendations are grouped into five distinct areas:

1. Disclosure in research reports;
2. Best practices for research reports;
3. Registration and supervision of analysts;
4. The importance of corporate governance to analyst independence; and
5. The importance of education in the marketplace.

#### 4.40 DISCLOSURE IN RESEARCH REPORTS

It is certain that analysts do face significant conflicts and the Committee worked hard to determine which conflicts could be balanced by disclosure and which ones should be disallowed because they would be difficult to mitigate. The proposed recommendations attempt to establish some standards of disclosure to ensure that investors have the information required to determine how independent the research recommendations are.

Currently, sell-side analysts, independent analysts and newsletter writers make recommendations that may prompt investors to buy, sell or hold stocks, often without any significant disclosure of the conflicts they face.

Dealers do not always voluntarily inform the investing public of the conflicts of interest within the firm that may affect a research recommendation. We applaud the recent move by some firms to address some of these conflicts by implementing guidelines for analysts within the firm. We believe that guidelines such as these have been necessary for some time and that they should be implemented at all dealer firms. However, these guidelines do not go far enough to protect the investor. The existing guidelines do not mandate sufficient disclosure of the dealer firm conflicts or disclosure of the conflicts due to the investment activities of the senior management of the firm. Without such disclosure investors cannot discern if any bias is or may be present in research recommendations.

We encourage member firms to adopt internal policies that adequately address potential conflicts of interest.

Analysts are now sometimes pressured by their employers to produce positive research for the purpose of attracting or retaining business and profiting from proprietary trading.<sup>13</sup> We believe that these conflicts can be addressed through disclosure.

Sell-side analysts receive remuneration from the dealers that employ them based in part on their contribution to the dealers' revenue. In some cases analysts may also receive direct remuneration from small companies for coverage, through payment for services, stock options or shares. Investors are entitled to know the sources of remuneration received by a research analyst so that the possibility of any bias is made clear.

If an analyst issuing a report, or making a recommendation on a company, holds any securities in the company, as of a specified date, or has received or knows he or she will receive remuneration or other benefit from the company in relation to its coverage, that should be disclosed.

Analysts do face significant conflicts.

We believe some conflicts can be addressed through disclosure.

<sup>13</sup> "Bay Street's weak-kneed analysts" by Eric Reguly, *Globe and Mail*, July 24, 1999. "Will upgrade of AT&T stock benefit Salomon?" by Randall Smith and Leslie Cauley, *Wall Street Journal*, December 12, 1999.

## KEY ISSUES AND RECOMMENDATIONS

Ensure that clear disclosure is made if an analyst holds interests in a company that is the subject of a report.

We believe that it may be a conflict of interest for analysts and their research associates to invest in the companies they are following. We do however have reservations about preventing analysts from investing in the very companies that they believe are good investments for their clients and their firms. We have therefore concluded that the way to protect investors and to allow analysts to invest is to ensure that analysts disclose any interest they hold in the companies they cover. This issue was clearly addressed in the Hagg Report.<sup>14</sup>

Similarly, where the firm's Pro Group holds more than a certain percentage of a company's securities, this should be clearly disclosed in the research report or written recommendation.

The Hagg Report concluded that, if member firms and their brokers and other employees are permitted to participate as principals in the financing of companies, those investments should be disclosed so that the clients of the member firms are made aware of the potential conflicts. The report recommended the disclosure of a dealer firm's Pro Group holdings when the firm's combined Pro Group holdings exceed 10% of the voting or equity securities of a company.

The Pro Group is defined in the Hagg Report as the member firm of a self-regulatory organization; its individual registrants, including directors, officers, registered representatives and investment advisers; its unregistered corporate finance professionals; employee shareholders; if applicable, partners of the firm; and certain associates of these individuals. This definition was altered slightly in the proposed IDA By-law 29.15(a) and the proposed TSE By-law 689 section 1.01, to include all member firm employees (thereby including analysts), and to use the definition of associate that is currently contained in the rules of the IDA and TSE and in many provincial securities acts.

The proposed definition of the Pro Group includes either individually or as a group, the member firm (of a self-regulatory organization), employees of the member and partners, directors and officers of the member and their associates and affiliates. The proposed rules grant the SROs the discretion to exclude a party from the Pro Group if it is determined that the party is acting at arm's length of the member; as well as the discretion to include a party in the Pro Group where that party is not acting at arm's length of the member.

- 1. The Committee endorses the concept of Pro Group reporting recommended in the Report of the Joint Securities Industry Committee on Conflicts of Interest, where the Pro Group is defined as in proposed IDA By-law 29.15(a) and proposed TSE**

<sup>14</sup> Joint Securities Industry Committee on Conflicts of Interest (1997)

By-law 689 section 1.01; and encourages the industry to implement this reporting requirement rapidly.

2. We recommend that the stock exchanges and the Investment Dealers Association of Canada require their members and participating organizations to disclose specific conflicts of interest in each research report and recommendation they issue on a company, including:
  - a) the Pro Group's holdings of any class of the company's securities, whether long or short, which in the aggregate exceed 5% of the outstanding securities of that class, as at a specified date;
  - b) if the analyst responsible for the report or recommendation and the analyst's associates hold or are short in any of the company's securities, directly or through derivatives;
  - c) if remuneration or other benefit has been or will be received by any member of the Pro Group from the company for services, and if the member firm has acted as an underwriter or adviser during the 24 months preceding the report or recommendation.

In the Draft Report this recommendation stated that the Pro Group's holdings should be disclosed when they exceed 10%. The comment letters clearly opined that 10% is too high and 5% was even considered too high by some parties who favour disclosure of all holdings. We recommend disclosure when the Pro Group's holdings of any class of a company's securities exceed 5%. While we understand that a 5% reporting threshold may be difficult to achieve at this time, the industry should work towards this goal. We also debated at great length whether the amount of shares owned by the analyst and associates should be disclosed in Recommendation No. 2 (b). The Committee could not come to agreement on this issue and recommends that the Stock Exchanges and the IDA consider whether the number of shares should also be disclosed.

3. We also recommend that such disclosure be readable and displayed prominently whether printed or disseminated electronically. In a summary report, where a brief comment may be made on a company, the investor should be referred to a previous full research report where this disclosure has been made, if one exists, or a comment should be made that such a report does not exist or may be forthcoming.

## KEY ISSUES AND RECOMMENDATIONS

While some conflicts can be mitigated by disclosure, we believe some cannot.

A research recommendation can be in potential conflict when a sell-side firm's principals are too close to the company being covered by research.

### 4.41 PROHIBITED RELATIONSHIPS FOR ANALYSTS

While some conflicts can be mitigated by disclosure, we believe some cannot. An analyst who has a close relationship with a company will have great difficulty in remaining objective about the company's prospects. The analyst must maintain independence while keeping in close touch with management of the company. When this relationship becomes too close and the analyst becomes an insider of the company, a much greater conflict occurs. We do not believe that any type of disclosure is adequate to address this level of conflict and that such conflicts should be prohibited for analysts issuing research recommendations on the company.

We are aware that the following recommendation may cause problems in cases where analysts working for investment dealers owned by banks wish to issue research on the parent bank. We recognize this situation and acknowledge that this is not the situation contemplated in the following recommendation. We believe that this will be reviewed and clarified during the implementation of our recommended changes.

4. We recommend that the Investment Dealers Association of Canada and the stock exchanges prohibit an analyst employed by a member or participating organization from issuing research on a company when the analyst serves as an officer, director, employee, or serves in any advisory capacity to the company.

### 4.42 DISCLOSURE OF RELATIONSHIPS BETWEEN DEALER FIRM PRINCIPALS AND THE COMPANY COVERED BY RESEARCH RECOMMENDATIONS

A research recommendation can be in potential conflict when a sell-side firm's principals are too close to the company being covered by research. When a sell-side analyst releases research or recommendations on a company in which officers or directors of the analyst's own firm are involved as principals, it is necessary that such relationships be disclosed. Such disclosure will provide the investor with the information to evaluate the potential bias of the report or recommendation.

5. We recommend that the stock exchanges and the Investment Dealers Association of Canada require their members and participating organizations to disclose prominently, in each research report or recommendation on a company, the name of each director, officer and employee of the dealer who is a director, officer or employee of the company, or who serves in any advisory capacity to the company.

#### 4.43 DISCLOSURE BY INDEPENDENT ANALYSTS AND NEWSLETTER WRITERS

Large companies with strong market following and very liquid securities are covered by many analysts. Smaller companies often have trouble obtaining analytical coverage after an Initial Public Offering. These smaller companies and start-up companies regularly struggle to be noticed by analysts and as a result their stock is less liquid. Such companies often pay independent analysts or investment newsletter writers for analytical coverage of their company's potential.

At first glance, it seems inappropriate for a company to pay an "analyst" for coverage. It is clear that in such situations analysts would have difficulty in being objective. Since the analysts are providing a paid service, their reports are apt to portray companies in a positive light. Independent analysts who write investment newsletters promoting companies are found throughout the industry and it is necessary for investors to understand when positive research is paid for and when it is truly independent.

We believe that newsletter writers and independent analysts, just like other analysts, must be compelled to disclose in their newsletters or reports when they have been paid to cover the company or if they have other conflicts of interest. With disclosure of this kind, the investor will have the information that enables an informed evaluation of the value and the bias inherent in the recommendation.

6. **We recommend that securities regulatory authorities require independent analysts and newsletter writers to disclose in their published research reports and recommendations on a company:**
  - a) **if the independent analyst or newsletter writer, or their associates, hold or are short in any of the company's securities, directly or through derivatives;**
  - b) **if remuneration or other benefit has been or will be received from the company for services during the 24 months preceding the report or recommendation;**
  - c) **if the independent analyst or newsletter writer is a director, officer or employee of the company or serves in any advisory capacity to the company.**
7. **We also recommend that such disclosure as required by recommendation No. 6 be displayed prominently in the published reports and newsletters of the independent analyst or newsletter writer.**

Smaller companies and start-up companies regularly struggle to be noticed by analysts. Such companies often pay independent analysts or investment newsletter writers for analytical coverage.

It is necessary for investors to understand when positive research is paid for and when it is truly independent.

## KEY ISSUES AND RECOMMENDATIONS

### 4.50 BEST PRACTICES FOR RESEARCH REPORTS

Many of our recommendations focus on best practices for research reports and for analysts. A total of 12 recommendations are presented that should be implemented and incorporated into a best practices guide for published research for analysts and dealer firms. These recommendations focus on important information, other than that concerning conflicts of interest, that needs to be disclosed to better understand a research report. We encourage the industry to review both the AIMR and SIA best practices guidelines that have been released during the past year for comment. We believe these guidelines are an important step forward and we encourage all participants in the industry to read and comment on them.

### 4.51 DISCLOSURE OF SOURCES OF INFORMATION

Although analysts rely on companies for some of the information that they use, they supplement that information from other sources and their own research and analysis to arrive at their recommendations. Analysts arrive at an opinion as to the value of the stock and project its value into the future.

It is not always easy to evaluate the difference between information that has been provided by the company, information that the analyst has obtained through other research, and the analyst's own assumptions and projections. Some investors may not appreciate the differences.

It is in the best interests of both analysts and investors that each research report distinguish information provided by the company from information obtained from other sources and from the analyst's own analyses and projections. This type of disclosure will help investors to understand the basis for the recommendations.

**8. We recommend that the Investment Dealers Association of Canada require its members to distinguish clearly in each research report between information provided by the company or obtained elsewhere and the analyst's own assumptions and opinions.**

Some concerns were expressed in the comments on this recommendation, suggesting that the implementation of such a recommendation might preclude future confidences, compromise experts and prove burdensome. The Committee does not agree with these concerns. It believes that it is important for investors to understand if a recommendation is based on good underlying information or if it is built on opinion and assumption.

It is not always easy to evaluate the difference between information obtained through research, and the analyst's own assumptions and projections.

It is important for investors to understand if a recommendation is based on underlying information or an opinion and assumption.

AIMR in its Code of Ethics and Standards of Professional Conduct advises its members to distinguish between facts and opinions in research reports and recommendations, but does not advise its members to distinguish between information provided by the company and information obtained from other sources. It should be clear to an investor when a recommendation is based on wide-ranging research or simply on information provided by the company.

In some cases analysts consult industry or professional experts in the course of preparing a research report. If an analyst has consulted with and relied upon the opinion of an industry or technical expert to make a specific recommendation, this should be disclosed. Where the name of an expert is disclosed, that expert's field and qualifications should be described generally.

- 9. We recommend that the Investment Dealers Association of Canada require its members to disclose in their research reports and recommendations reliance by the analyst upon third party experts other than the analyst responsible for the report; and to name the third party experts.**

#### 4.52 DISCLOSURE OF SITE VISITS

In the analysis of companies in industries where inspection of a company's properties provides a better understanding of the company's prospects, site visits may be desirable to enable the analyst to evaluate the company effectively. This applies especially to smaller companies in the mining or oil and gas industries, with one mine or potential mine, or one oil or gas well or potential oil or gas well. When a site visit has been undertaken in connection with the preparation of a report, the visit should be disclosed.

- 10. We recommend that the Investment Dealers Association of Canada require its members to disclose in their research reports if and to what extent the analyst has viewed the material operations of a company, in circumstances where such visits would assist in the analysis of the company's operations and would be material to the report.**

#### 4.53 STANDARDS FOR RECOMMENDATIONS

Most research reports are high quality, reflecting the competitive nature of the business. Good quality research is good for business. There is little to be gained from interfering in an area where competitive forces keep standards high. We also appreciate that differences in the design and structure of research reports differentiate one firm's research

In some cases analysts consult industry or professional experts in the course of preparing a research report.

When a site visit has been undertaken in connection with the preparation of a report, the visit should be disclosed.

## KEY ISSUES AND RECOMMENDATIONS

### Current recommendations used:

Mega strong buy  
Strong buy  
Best buy  
Focus buy  
Single best idea  
Neutral  
Market perform  
Select list  
Add  
Buy  
Speculative  
Outperform  
Under-perform  
Below market performer  
Avoid  
Reduce  
Sell  
Strong sell  
Accumulate

product from those of its competitors. However, we do believe there is some room for improvement to ensure that investors clearly understand the research report recommendations. We believe that clarity in all research reports and recommendations is important.

One issue that was raised was the fact that there is no standard recommendation key that all analysts use. Every dealer firm and many analysts use their own unique system for rating their research recommendations. The definition of a “buy” recommendation in one firm may equate to another firm’s “strong buy” or even “hold” recommendation.

The traditional “buy,” “hold” and “sell” recommendations have been expanded to include numerous terms whose meaning is not clear without comparison to the range of recommendations. It has been suggested that the rating terms are often intentionally opaque because dealers are leery of offending underwriting clients.<sup>15</sup>

In addition, some dealers use a numerical rating system as a form of product differentiation. This plethora of terms and different systems has led to confusion. Dealers create elaborate models for their recommendations to differentiate their recommendations from all the others on the street, but the result is that many investors find the different models merely confusing and not comparable.

We considered and rejected the concept of recommending standard terminology, such as buy, sell and hold, for recommendations. While this would standardize terminology in Canada, it would be incompatible with the ratings systems developed by some firms and since many research reports are generated outside of Canada it would not standardize terminology at all. Instead, we propose that the terms or ratings used in any research recommendation should always be put in context by providing an explanation of the terms or ratings.

**11. We recommend that the Investment Dealers Association of Canada require its members to explain the meaning of the recommendation or rating used in each research report, and where that ranking fits within the full range of recommendation terminology employed by the analyst.**

**12. We also recommend that investment dealers disclose on their websites or otherwise, on a quarterly basis, information available to the public as to the percentage of their recommendations that fall into each category of their recommendation terminology.**

<sup>15</sup> “The hidden language of stock ratings”  
by Carolyn Leitch, *Globe and Mail*,  
June 3, 2000.

#### 4.54 CONTINUING ANALYTICAL COVERAGE

One issue that was raised in several comments about the Draft Report focused on the fact that very few analysts continue analytical coverage on companies that are no longer “buys.” It is evident that sell-side firms rarely continue analytical coverage on companies that no longer have favorable recommendations. Investors, however, place great value on such information. Investors would like to see analysts update their recommendations when a company releases material information. At the very least, investors would like to know when an analyst has discontinued coverage of a company. A commitment to continued coverage would demonstrate a commitment to investors and to making available balanced information in the marketplace.

13. **We recommend that investment dealers adopt standards of research coverage that include, at a minimum, the obligation to maintain and publish current financial estimates and recommendations on securities followed, and to revisit such estimates and recommendations within a reasonable time following the release of material information by an issuer or the occurrence of other relevant events. Investment dealers should publish notice of their intention to suspend or discontinue coverage.**

#### 4.55 MEDIA INTERVIEWS

Where analysts give media interviews and discuss company recommendations, the analysts should also clearly reveal any conflicts.

14. **We recommend that in media interviews analysts being interviewed state, or cause the interviewer to state, conflicts of interest that could affect the analysts’ opinions, to the extent feasible and in a general way.**

The Committee is aware that this recommendation may be somewhat impractical in application. While several of the comment letters pointed out the impracticalities, it is equally clear that efforts should be made to communicate to investors when conflicts do exist. To quote from an AIMR publication, *Preserving the Integrity of Research*, dated July 10, 2001, investment professionals and their firms, whether buy- or sell-side, “should make a reasonable effort to ensure that these (actual) conflicts are made public,” when being interviewed by the media. A proposed amendment to NASD Rule 2210 also suggests requiring certain disclosure when an analyst makes a public appearance such as in a seminar, or in a radio or television interview. It is clear that while this is difficult to define or enforce, the concept of disclosing conflicts in media interviews is widely supported.

Investors would like to know when an analyst has discontinued coverage of a company.

Where analysts give media interviews and discuss company recommendations, they should also clearly reveal any conflicts.

The concept of disclosing conflicts in media interviews is widely supported.

## KEY ISSUES AND RECOMMENDATIONS

Price targets are one of the best ways to quantify research and assess value.

Some industries use very specific terminology and the use of other terms is misleading to investors.

### 4.56 PRICE TARGETS

The Committee also noted a tendency for some investment dealer research reports not to publish price targets for company shares, in part due to potential liability issues. The Committee concluded that where sufficient information is given, and there is a reasoned approach to the determination of a target price, such estimates can and should be made. Price targets are one of the best ways to quantify research and assess value and should be part of any best practice guidance.

**15. We recommend that setting price targets should be part of best practices for research, where possible and with the appropriate disclosure.**

### 4.57 USE OF SPECIFIC TERMINOLOGY FOR SOME SECTORS

Some industries such as biotechnology, computer technology, mining and oil and gas require the use of technically specific terminology. An analyst who covers this type of company or sector should use the standard terminology that is required or commonly used in these industries. The use of accepted sector specific terminology will facilitate not only the investor's understanding of the company but will allow the investor to compare the opinions and recommendations expressed in the research report with those of other analysts and with the company's own disclosure.

There were several comments on this recommendation in the Draft Report. Some commentators strongly supported this recommendation, since some industries use very specific terminology and the use of other terms is misleading to investors. Other commentators were adamant that specific terminology will make the research reports unreadable and that investors' interests will not be served. We did conclude that specific terminology should be used to make the reports accurate. However, when needed, glossaries should be attached to explain the terms used.

One comment letter raised the important points that terminologies may vary from country to country and that what may be correct in one jurisdiction may not be in another. We considered that point important and do believe that if a glossary is attached investors' interests will be served.

**16. We recommend that the Investment Dealers Association of Canada require its members, in each research report, to use the specific technical terminology that is required by the relevant industry, professional association or regulatory authority. Where necessary for full understanding, a glossary should be included.**

#### 4.58 DISSEMINATION OF RESEARCH REPORTS

Analysts produce different kinds of research for their dealer employers ranging from full research reports, which may take weeks of research and preparation, through to brief recommendations and morning notes. Research is disseminated through various channels and may be mailed, faxed or e-mailed to clients. Morning notes may be posted on the Internet or faxed to selected clients. Retail brokers participate in the “morning meeting” at most firms and will then telephone their own clients with news of interest to each.

This report focuses on comments about written reports. We recognize that the type of disclosure we are recommending does not work for verbal discussions with clients about recommendations. Verbal recommendations to clients should be backed up by a written report that contains the requisite disclosure and that can be accessed by the client.

The Internet makes all of this possible. Before the wide use of the Internet, research was disseminated by central mailing to certain clients and through the firm’s broker network using the mail, facsimile transmission and personal communication. Today many clients receive their research reports electronically. Many dealers now make full research reports or recommendations available on the Internet to certain clients with password access, while other dealers make their research available to all investors free of charge as a kind of “loss leader” to attract business to the firm.

An IDA survey of 30 of its large members conducted in June 2000 shows that the majority of those surveyed post research reports on their websites for their clients to access. Of the 30 firms surveyed, 21 reported that they post research on their websites for their clients, six do not post any research and two indicated that they plan to have research on their websites soon. The remaining member generates no research in Canada. Some have separate sites for their institutional and retail clients.

**17. We recommend that investment dealers make their analysts’ research widely available through their websites or by other means for all of their clients whom they have determined are entitled to receive such research; and, in order to ensure fair treatment, to make the analysts’ research available to all such clients at the same time.**

For many investors the personal touch is still required and the telephone remains an important method of discussing potential investments with their brokers. These discussions do not convey all of the information available in the written text of a research report and therefore investors

This report focuses on comments about written research reports.

## KEY ISSUES AND RECOMMENDATIONS

Research is treated as a product that is part of the competitive environment among dealers.

Institutional investors impose a discipline on dealers to produce effective and good quality research by having the ability to direct commission fees for trade execution.

who want enough information to evaluate the objectivity of the research or recommendation should request the written research report.

Some dealers make their research available to clients in order of priority. Research is treated as a product that is part of the competitive environment among dealers. We believe that investors should be aware of their dealer's policies with respect to the dissemination of research.

**18. We recommend that the Investment Dealers Association of Canada require its members to state their research dissemination policies on their websites or by other means.**

Institutional clients do continue to have better and timely access to research recommendations, in part because of the longstanding professional relationships and continual contact. The use of Internet technology now allows dealer firms an economical and simple way to ensure that all clients who are entitled to receive research have the same access.

Commentators were primarily in favour of recommendation Nos. 17 and 18. The Committee would like to emphasize that these recommendations address our concerns that all clients should receive fair treatment.

### 4.59 ROLE OF INSTITUTIONAL INVESTOR

As a corollary to the concept of best practices for research reports, the Committee suggests that institutions have a role to play in ranking analysts, and thereby perhaps contributing to higher standards.

Institutional investors impose a discipline on dealers to produce effective and good quality research by having the ability to direct significant commission fees for trade execution to dealers that provide value-added research. As institutional investors vary significantly, this practice is not consistent among all buy-side institutions. Some institutions use sell-side research and are organized to evaluate the quality and objectivity of research, and subsequently allocate commission revenues systematically to those dealers that provide a recognized value-added product. This assessment process can be quite detailed. The results of this buy-side review are often disclosed publicly to investment dealers and spur intense competition.

The process in turn encourages dealers to improve and strengthen their research analysis and also to inculcate a standard of high ethical conduct within these firms. The market is served by several independent firms that survey institutions on a quarterly and annual basis to assess the effectiveness of dealer research, sales and trading functions. The results

of these surveys are distributed widely across the financial community. However, these services can only be effective in encouraging objective research if the results are used by institutions to impose high standards for sell-side research. The Committee believes the comprehensive review of sell-side research could be more widespread across the institutional sector, which would provide an effective incentive for good quality research.

**19. We recommend that institutional investors, acting together or individually, use best practices criteria to measure the value added by analysts and, to the extent feasible, use such criteria in allocating commission business.**

#### 4.60 REGISTRATION AND SUPERVISION OF ANALYSTS

AIMR promotes high standards for analysts, but is an educational rather than a self-regulatory disciplinary body. Nevertheless, we believe that its high standards are useful guidance for analysts in the conduct of their affairs. For example, AIMR provides the following advice:

“Although analysts may not have as much client contact as other investment professionals or as many advisory responsibilities as investment advisors, ... they still have basic responsibilities to their employers and their employer’s clients. They owe the same duty of independent judgment, adequate disclosure, and fair dealing as investment professionals with client contact. Members who are financial analysts should strive to maintain independence and objectivity when undertaking their analyses.”<sup>16</sup>

We believe that all Canadian analysts should be subject, at a minimum, to the standards and restrictions that we recommend in this report. The Committee also believes that the advantages of becoming a Chartered Financial Analyst (CFA), and working under the continued guidance that AIMR provides to its members, makes AIMR membership very attractive.

**20. We recommend that investment dealers require their analyst employees to obtain the Chartered Financial Analyst designation.**

We commend AIMR for its excellent standards and encourage Canadian analysts to pursue membership. We would however encourage stronger enforcement. We encourage AIMR to monitor the activities of CFAs more stringently; and if that is not feasible, then we recommend that the Canadian societies of AIMR monitor and enforce the AIMR standards. Nevertheless, we do believe that the CFA designation is only one of many

AIMR promotes high standards for analysts, but is an educational rather than a self-regulatory disciplinary body.

We believe that all Canadian analysts should be subject to the standards and restrictions that we recommend in this report.

<sup>16</sup> AIMR Standards of Practice Handbook, 8th ed., 1999, pages 217–218.

## KEY ISSUES AND RECOMMENDATIONS

The CFA designation is only one of many measures of proficiency and professionalism.

measures of proficiency and professionalism, and that a CFA designation cannot be mandatory across the entire profession. Post-secondary education in fields such as finance, business administration and accounting, and expertise in industry sectors gained through self-education and field experience, are also very important. In addition licensed professionals such as professional engineers, professional geologists, certified accountants, certified business valuers, doctors and lawyers all offer specialized expertise to dealer firms for specific industries and adhere to enforced codes of ethics and standards of practice. Investment dealer firms use common sense and good judgement when determining the education and experience that an analyst needs to do a good job for the firm and this should remain the responsibility of the firm.

### 4.61 REGISTRATION OF SUPERVISORY ANALYSTS

The role of the sell-side analyst spans both investment advice and in many cases the marketing of services for the firm. We believe that this activity can be interpreted, in the parlance of securities legislation, as “acts in furtherance of a trade,” which is precisely the activity that has required the registration of brokers, officers and directors of dealer firms.

Despite an analyst’s central role in advising Canadian analysts employed by dealers have not generally been required to register under securities legislation. Some sell-side analysts are registered as officers or directors of the dealer where they are employed; however, this is substantively different from being registered in a category relevant to their profession. While there is no question that there are no specific rules that govern the conduct of analysts in the marketplace, if there is ever a need to discipline an analyst, there is a process to do that through a firm’s due process. It can also be argued that there are fiduciary responsibilities to at least some clients who use analysts’ research.

We understand that many analysts in the US who are dealing with clients are now registering under the SEC Series 7. as General Securities Representatives. However, there is no registration category specifically for analysts in the United States, other than for a supervisory analyst.

The IDA by-laws require that all sales literature, including research reports, be approved before issuance by a partner, director, officer or branch manager who has been designated in writing by the IDA member as being responsible for sales literature. Among other things, members must not issue sales literature which: is false or misleading; contains an unjustified promise of specific results; uses unrepresentative statistics to suggest unwarranted or exaggerated conclusions, or fails to identify the material assumptions made in arriving at the conclusions; contains an

opinion or forecast of future events which is not clearly labeled as such; or fails to fairly present the potential risks to the client. There are no specific requirements imposed on the person who reviews research in a firm, such as a CFA qualification, although we would expect that firms would have competent people carrying out the approval function.

In the United States, under New York Stock Exchange (NYSE) rules, there is a more specific requirement for a supervisory analyst. All research reports must be prepared or approved in advance of publication by a supervisory analyst acceptable to the NYSE. To be acceptable to the NYSE, the individual must present evidence of appropriate experience and either pass the NYSE's Supervisory Analysts Examination or complete a specified level of the CFA and pass that part of the Supervisory Analysts Examination dealing with NYSE rules on research standards and related matters. Appropriate experience means having at least three years of prior experience within the immediately preceding six years involving securities or financial analysis. When a firm has no person qualified as a supervisory analyst, the firm can arrange to have its research approved by a qualified person in another firm.

Many firms have CFA charterholders, who are experienced professionals and review research emanating from their firms. The Committee believes it would enhance the level of quality control and supervision across the industry if all persons responsible for reviewing research in firms are required to have completed certain proficiency requirements and be registered. Registration is the foundation for the regulation of dealers and individuals in the securities industry. The grant of registration is conditional on meeting certain minimum requirements and agreeing to abide by securities rules and policies. A qualification for registration is the demonstration of proficiency through the mastering of a series of exams and the accumulation of experience in the market. Registration not only ensures that registrants are capable of doing their jobs but also ensures investors that a standard of supervision is in place and that adherence to securities laws is enforced.

Continued registration is dependent upon compliance with mandated minimum standards such as the disclosure of conflicts and the adherence to securities regulations and SRO rules. Withdrawal of registration is the device used by regulators to eject those who do not adhere to the rules that govern the securities industry. Securities regulatory authorities have power to initiate proceedings against registered individuals who do not comply with these rules, which can lead to serious consequences. SROs are limited to disciplining registrants. Securities Commissions and courts may impose penalties on anyone, not just registrants, penalties

It would enhance the level of quality control and supervision across the industry if all persons responsible for reviewing research were required to be registered.

## KEY ISSUES AND RECOMMENDATIONS

which may include serious fines, temporary or permanent withdrawal of trading privileges and the prohibition to serve as an officer or director of any company active in the capital marketplace. For anyone working in the securities industry, penalties such as these are serious and have a long-term negative effect on a career.

While we did consider recommending the creation of a registration category for all research analysts within an IDA member firm, there are several reasons for not pursuing such a requirement at this time:

- There is no specific registration requirement for all research analysts employed by NYSE/NASD member firms. That means that research material, including research reports and commentary from US securities houses, which in some cases may be prepared by unregistered analysts, could find its way to Canadian investors, thus creating a double standard.
- The registration and formal regulatory oversight procedures for research analysts would be costly, particularly in connection with potential investigations of improper recommendations. We questioned whether the benefits of registering all analysts could justify the costs.
- Registration procedures for all analysts would result in inconsistent treatment of industry professionals. The existing regulatory standard has been interpreted to require registration for industry professionals who have direct contact with their clients and are engaged in providing financial advice and in taking orders or trading securities. However, most analysts are involved in the research and analysis of securities and capital markets, and only occasionally communicate information and research findings directly to retail and small institutional investor clients. Accordingly, it was questionable whether analysts should be treated any differently from corporate finance professionals who have responsibility for signing prospectus documents and other disclosure materials that are distributed to investors.

Consequently, after careful consideration, the Committee decided that it should not recommend the registration of all sell-side analysts at this time. We believe the securities commissions should consider whether the current registration requirements should be interpreted to include certain analysts and other market participants.

The Committee recommends the creation of a category of supervisory analysts and registration of this category. The supervisory analyst would be responsible for all materials produced within the research department of an IDA member firm, and accordingly would carry

Supervisory analyst would be responsible for all materials produced within the research department.

sufficient responsibility to justify registration. The registration of a supervisory analyst also allows for closer oversight and the application of a standard of practice throughout the industry.

**21. We recommend that the Investment Dealers Association of Canada require each of its members to appoint a supervisory analyst who will be responsible for approving all research reports and recommendations in advance of publication.**

**22. We recommend that the Investment Dealers Association of Canada develop proficiency standards for supervisory analysts which mandate attainment of the Chartered Financial Analyst designation and require prior industry experience and self-education. The proficiency requirements should grandfather long practising supervisory analysts, regardless of formal qualifications.**

We also believe that, in conjunction with the registration of supervisory analysts, all analysts should be required to adhere to and certify annually that they adhere to the AIMR Code of Ethics and Standards of Professional Conduct or the “Made in Canada” equivalent. The AIMR Code of Ethics and Standards of Professional Conduct are presented in Appendix IV and provide an excellent model for the industry to follow or use as the basis for a Canadian equivalent.

**23. We recommend that the Investment Dealers Association of Canada develop a process of annual certification to ensure that all analysts comply with the AIMR Code of Ethics and Standards of Professional Conduct (or the Canadian equivalent) whether or not they are members of AIMR; and that the process require that both a firm’s research department head and chief executive officer (or equivalent — see Recommendation No. 26) certify analyst compliance to the standards.**

**24. We recommend that the Investment Dealers Association of Canada investigate and if appropriate develop a Canadian Code of Ethics and Standards of Professional Conduct for analysts.**

The majority of commentators were clearly in favour of these recommendations. It was suggested that in order to accept research from the US the IDA should accept the qualifications of a registered supervisory analyst in the US. This would help avoid unnecessary duplication in some cross-border firms and help move towards common regulation in North American markets. Some commentators suggested that all analysts should be subject to these proficiency standards and registration. The Committee believes that in some cases specific industry experience can be more important than the CFA designation. Firms

KEY ISSUES AND RECOMMENDATIONS

Independent analysts should be required to adhere to the same Code of Ethics and Standards of Professional Conduct as sell-side analysts.

should be able to have technical experts on staff without the CFA designation, as long as a registered supervisory analyst is available to ensure that high standards are adhered to in research and recommendations.

Independent analysts and newsletter writers resident in a Canadian jurisdiction have been required to register with securities commissions as investment advisers when they are truly advising clients. While this registration does exist it has not been widely enforced and should be much more rigorously enforced than it has been to date. In addition we recommend that independent analysts should be required to adhere to the disclosure requirements for sell-side analysts and to the AIMR Code of Ethics and Standards of Professional Conduct, in the interim, and to the Canadian equivalent, if and when developed. Comments on the Draft Report suggested that rather than merely encouraging independent analysts and newsletter writers to adhere to the code and standards, the Committee should actually recommend this step be taken.

**25. We recommend securities regulators exercise their jurisdiction to require independent analysts and newsletter writers to adhere to the same Code of Ethics and Standards of Professional Conduct as sell-side analysts.**

In some cases a dealer's reporting structure will result in pressure on analysts to release favorable research.

**4.70 THE IMPORTANCE OF CORPORATE GOVERNANCE TO ANALYST INDEPENDENCE**

The Committee determined that in some cases a dealer's reporting structure will result in pressure on analysts to release favorable research. The management of this conflict needs to be addressed within the firm and by the firm's corporate governance and reporting policies.

In many firms much of an analyst's remuneration is based on a bonus system that is in part based on the revenue of the firm, the analyst's contribution to that revenue and the possibility of repeat business with good clients. A significant portion of dealer firms' revenues is now derived from corporate finance business. The quality of analysts' work is also evaluated in part by the feedback from the companies that they cover. If an analyst is perceived as not contributing to the revenue-generating part of the business or to client support, the analyst's compensation could be severely impacted.

Much of an analyst's remuneration is based on a bonus system that is in part based on the revenue of the firm.

If this remuneration structure is combined with the wrong reporting structure, it can have the effect of exacerbating conflicts of interest. If the research staff reports to the head of corporate finance, analysts at the firm could easily find themselves under strong pressure to make

recommendations to please potential underwriting clients and improve corporate finance revenues, or risk poor performance appraisals.

The reporting structure of dealers varies. For example, in some firms, the research department reports directly to the CEO of the firm, while in others research may report to the head of corporate finance or to institutional trading. It is important for the research function to report to a senior officer, such as the CEO, who has the overall reputation and long-term prospects of the firm in mind. This reporting structure would limit the daily conflicts of interest arising from short-term issues. It would also reduce the pressures to favour potential underwriting clients in research and recommendations and place the direct and ultimate responsibility for managing these conflicts at the highest level of the firm.

The importance of the proper reporting relationship cannot be over-emphasized. A reporting structure in which analysts must report to officers who face direct conflicts of interest places those employees in an untenable position. The analysts' careers may suffer if they do not bow to either subtle or overt pressure from the officer who evaluates their performance. This is not an academic argument. It was notable that during the period of time when one company was being investigated by the OSC for high closing violations, the company changed its reporting structure so that traders no longer reported to portfolio managers. Before the change of reporting structure, portfolio managers who had a financial interest in the performance of the portfolios directly supervised and oversaw all of the activities of the traders. The company changed the structure to ensure that the traders reported to an officer who was not being measured on portfolio performance.<sup>17</sup> We believe that the reporting structure recommended will foster analysts' independence.

**26. We recommend that the Investment Dealers Association of Canada require each of its members to have the head of the research department, or in small firms where there is no head, then the analyst or analysts, report to the chief executive officer or to another senior officer who is not the head of the investment banking department and who is acceptable to the IDA.**

The Committee has concluded that mandatory annual certification of compliance with the AIMR Code of Ethics and Standards of Professional Conduct by analysts will encourage such analysts to adhere to high standards of ethics and business conduct in carrying out their research activities. The Committee further concludes the incentive to meet a high standard of conduct is reinforced if (a) the head of the research department or, in the case of small firms where there is no head, the

The importance of the proper reporting relationship cannot be over-emphasized.

<sup>17</sup> "Managers batten down hatches on policy, practices," *Globe and Mail Report on Business*, July 21, 2000.

## KEY ISSUES AND RECOMMENDATIONS

Research department heads and chief executive officers would be expected to confirm analyst compliance with the AIMR Code and Standards.

chief executive officer or other appropriate senior officer, and (b) where there is a head of the research department, the chief executive officer or other senior officer acceptable to the IDA, are each required to certify to analyst compliance with these standards. The Committee fully recognizes the practical limitations of requiring supervisory personnel to certify that an analyst has complied fully and consistently with the AIMR Code of Ethics and Standards of Professional Conduct in the course of his or her activities. In this regard, the Committee expects the wording of the certification to be acceptable to the IDA. We would expect that the certification would contain suitable qualifying language that addresses the realities of the situation. For example, research department heads and chief executive officers would be expected to confirm compliance with the AIMR Code and Standards, qualified with wording such as “to the best knowledge and understanding” of the supervising individual.

The proposed certification process places an important obligation on analysts, and executives supervising analysts, to ensure that research activities are conducted in an ethical and professional manner. This discipline will go a long way towards instilling an ethical culture within the research department of the firm, and indeed across all operations of the firm, enabling the analyst and the firm to “walk the talk” with respect to high ethical standards. This conduct will result in objective and independent research and will strengthen investor confidence in the quality and objectivity of the research process.

### 4.7I TRADING AHEAD OF RESEARCH

When a dealer firm initiates research coverage of a company and makes its first recommendation, some trading in that stock may be expected to take place. Any significant change in such a research recommendation could also generate interest and possibly trading activity in the stock.

Where this occurs a dealer can buy or sell short or decrease a position before the new recommendation is released and then sell to its clients or lower its short position after the market has reflected a change due to the new recommendation. While this is not technically frontrunning or insider trading, if the dealer’s information can be reasonably expected to move the market price this is a manipulation of the market. The exchanges currently prohibit frontrunning clients’ orders because it is a manipulative method of trading. By trading ahead of a client order the dealer can acquire the stock at a lower price and then sell the stock after the client order has caused the price to rise. This benefits the dealer rather than the client or other clients of the dealer.

Trading ahead of recommendations has been addressed in the United States by the major stock markets and by AIMR. Both the NYSE and NASDAQ have issued notices to inform their members that acquiring a position in a listed security, in contemplation of issuance of a favorable research report, is not in keeping with just and equitable principles of trade.<sup>18</sup> The NASDAQ interpretation is expanded to include increasing, decreasing or liquidating a position. AIMR members are required to give their clients and employer adequate opportunity to act on their recommendations before acting on their own behalf.<sup>19</sup> The combination of the market interpretations of just and equitable principles of trade and the application of AIMR standards should effectively prevent dealers and analysts from trading ahead of recommendations.

The TSE, ME and CDNX rules also require their participating organizations and members to transact business in accordance with just and equitable principles of trade. All three have a rule prohibiting front-running client trades but no rule or interpretation relating to trading ahead of recommendations. A dealer trading in advance of any information that may affect the price of the security is taking advantage of that information at the expense of its clients rather than providing a service to those clients. A dealer trading ahead of its own clients based on proprietary information creates an appearance of impropriety that harms the perception of the market and affects investor confidence in the market.

The Canadian Securities Administrators asked the Committee to consider this issue since it has been on its policy agenda and believes it is an issue that needs consideration. Dealer firms should not be allowed to use advance notice of the contents of research reports for their own benefit, at the expense of their clients and the fairness of the market place. It is clear that appropriate compliance procedures are necessary to ensure that a firm does not trade on its advance knowledge of research recommendations and thereby disadvantage its own clients.

We do, however, recognize that dealers differ greatly in size and culture and that this should be taken into account in any regulatory response to the issue. It was suggested that, because firms vary in size, procedures to keep research information from trading and sales staff until a report is disseminated should be left to the individual firms. Another comment stated that the use of certain kinds of proprietary information, other than research-related proprietary information, may be perfectly appropriate in many circumstances, since “the ability of dealers to profitably manage inventories of stock is based on this very use of such proprietary trading information,” and therefore the standard of this recommendation was too high. There is no currently recognized standard compliance

Firms should not be allowed to use advance notice of the contents of research reports for their own benefit.

<sup>18</sup> NYSE Information Memo, 1991; NASDAQ Interpretation, 1995.

<sup>19</sup> *AIMR Standards of Professional Conduct*, Standard IV, (B.4.) – Priority of Transactions.

## KEY ISSUES AND RECOMMENDATIONS

Attention to effective compliance and corporate governance within dealer firms is crucial.

procedure to deal with this issue and the Committee believes that there should be. We believe that investment dealer firms should have effective compliance procedures in place which ensure that insider knowledge does not give firms advantages over their clients.

27. We recommend that the stock exchanges and the Investment Dealers Association of Canada prohibit members and participating organizations and their employees from establishing, increasing, decreasing or liquidating a position in a listed security, or a derivative security based principally on a listed security, based on knowledge of or in anticipation of the dissemination of a research report, a new recommendation or a change in a recommendation relating to that security by that member or participating organization that could reasonably be expected to have an effect on the price of the security.

28. In firms that do not prohibit analysts from owning securities they cover, we recommend that analysts be required to obtain approval from their supervisor prior to executing any trades in securities of companies that they cover. We further recommend that, in the absence of special circumstances, approval to trade contrary to an analyst's current recommendation should be withheld.

### 4.72 COMPLIANCE AND CORPORATE GOVERNANCE IN DEALER FIRMS

Attention to effective compliance and corporate governance within dealer firms is crucial to ensuring that conflicts of interest are well managed within the firms. Without this attention to effective compliance and governance, analysts within the firms will continue to be subjected to conflicts of interest that they have no hope of managing and which can affect the objectivity of their research.

Internal compliance policies within dealer firms to address potential analyst conflicts may include, in addition to requirements to comply with all applicable laws, such things as:

- the adoption of internal review procedures and guidelines to determine when dealers and their analysts have received non-public material information and how they should deal with such situations;
- a requirement to pre-clear personal trades in both publicly traded securities and private placements;
- a requirement to pre-clear any outside directorships or outside business activities;

- a prohibition on analysts trading securities on the firm's Restricted List;
- a prohibition against analysts engaging in any trade that would involve them putting their interests ahead of those of a client of the firm;
- a prohibition against analysts engaging in any trade misusing knowledge of trading activity, plans or strategies of their firm or its customers;
- a prohibition on analysts making investments in securities of issuers they cover where it could be construed to affect the independence of their research;
- a prohibition against analysts trading in a security while they are in the process of preparing a research report or changing a recommendation or materially changing a target price or forecast in relation to that security, and for a reasonable period thereafter; and
- a prohibition against analysts trading a security contrary to their recommendation in relation to that security.

Each dealer must have policies in place to ensure that the firm complies with all the legal and regulatory requirements in the capital marketplace and to maintain an ethical standard of behavior to protect its clients. In most firms compliance issues are taken very seriously and the compliance staff are effective and vigilant. There are, however, examples of compliance procedures not being enforced or adhered to and there have been some serious incidents that have been the subject of regulatory proceedings and litigation in the past few years in firms where compliance procedures were ignored. It is important for all dealers to address the management of conflicts and ethical standards adequately. At the very least, a firm's policies must aim for compliance with applicable securities laws and SRO rules.

One comment on the Draft Report stated that the conflict of interest policies should be left to the individual firms. Another suggested the Committee develop and refer to a specific set of procedures and principles. It is the Committee's conclusion that the IDA could perhaps best implement the following recommendation by developing a generic draft conflicts of interest policy that each member could use as the basis for its own policy. We leave this to the IDA on how best to implement this, but do believe that at the minimum each firm must establish a policy to handle conflicts of interest.

**29. We recommend that the Investment Dealers Association of Canada require its members to develop, establish and enforce conflict of interest policies that adequately address the conflicts of interest faced by analysts within their firms.**

It is important for all dealers to address the management of conflicts and ethical standards adequately.

KEY ISSUES AND RECOMMENDATIONS

Commitment to governance is the responsibility of a board of directors and senior management.

Boards and CEOs who want their analysts to have high professional standards will make it happen.

20 “Brokerage scandals and the high cost of ethical folly,” *Globe and Mail Report on Business*, June 29, 2000.

Attention to appropriate corporate governance is a necessary activity for dealer firms in order to address internal conflicts of interest that affect analysts and the quality of research recommendations.

A cavalier attitude towards ethics may improve the bottom line for the short term but, for the long-term health of a firm and the securities industry, a strong commitment to managing conflicts of interest is necessary. Scandals in the marketplace harm the entire industry and have a deleterious effect on all participants. J.R. Finlay of the Centre for Corporate & Public Governance commented recently on high closing allegations against some market participants.

“In my frequent conversations with employees in the securities industry, I am struck by the number who say that management conveys one message publicly about the importance of ethics, but privately seems to encourage a different set of performance standards when it comes to meeting the bottom line.”<sup>20</sup>

Commitment to governance and ensuring the enforcement of standards is the responsibility of a board of directors and senior management and must be communicated to everyone in a firm. Good governance requires management support and example, and both the board of directors and chief executive officer of a firm are responsible for creating a culture in which ethical practices are encouraged and rewarded.

The most effective way to develop the independence and professionalism of sell-side analysts is for the dealers’ boards of directors and chief executive officers to “walk the talk.” Boards and CEOs who want their analysts to be independent and to have high professional standards will make it happen.

While some of our other recommendations address these issues, it remains the leaders of a firm who set the tone for the independence and professionalism of their analysts. They must ensure that the firm’s compliance procedures adequately address the conflicts of interest faced by analysts within the firm and that the compliance procedures are adhered to.

30. We endorse By-law No. 38 passed by the Board of Directors of the Investment Dealers Association of Canada on October 18, 2000, which requires every IDA member to “designate its Chief Executive Officer, its President, its Chief Operating Officer or its Chief Financial Officer (or such other officer designated with the equivalent supervisory and decision-making responsibility) to act as the Ultimate Designated Person (the “UDP”) who shall be

**responsible to the applicable self-regulatory organization for the conduct of the firm and the supervision of its employees.”**

Specifically, it will be the responsibility of the UDP to ensure that any procedures regulating the conduct of analysts are adopted and applied in a meaningful way. Since the publication of the Committee’s Draft Report, the Committee has been pleased to learn that some IDA members have already implemented By-law No. 38 and designated an officer as the Ultimate Designated Person.

One commentator considers analysts should be accountable for their own work and thinks that will only be feasible if analysts are members of a self-regulating organization. As analysts come from a variety of backgrounds, work around the world and are subject to a variety of regulatory frameworks, an efficient self-regulating organization will be difficult to establish. We suggest that better supervision, better enforcement by AIMR, enforceable best practices and registration will increase the value and effectiveness of analytical research in the marketplace.

One commentator suggested that there should also be an ethics committee of the IDA member’s board of directors, or the board should create an office of ethics ombudsman to monitor compliance within a firm. We believe that this would already be in place, through the compliance activities within firms together with implementation of the recommendation presented above.

#### **4.73 PUBLIC COMPANY INTERACTION WITH ANALYSTS**

Analysts have always experienced some subtle pressure by some companies to issue positive research coverage. Companies have also been known to complain to dealer management about a particular analyst after an unwelcome report or recommendation released by the dealer’s research department. While many public companies are balanced and fair in their dealings with analysts, some do pressure analysts, often in a very subtle way, to write favorable reports by suggesting that the firm will lose the corporate finance business and the analyst will risk losing access to the company staff. This is completely inappropriate and ultimately hurts the very company that is pressuring the analyst.

Analysts in the US have even been the subject of defamation actions upon questioning the profit potential of a company<sup>21</sup> and have received threats after downgrading shares in some companies.<sup>22</sup> We were also made well aware, from the submissions and presentations that we received, of the common, sometimes subtle, pressure applied to analysts by some companies.

Analysts come from a variety of backgrounds, work around the world and are subject to a variety of regulatory frameworks.

We do not think it is in the interest of companies to put pressure on analysts.

<sup>21</sup> “Analysts Risk Suits for Reports,” *Wall Street Journal*, December 29, 1999.

<sup>22</sup> “Downgraded,” *The Economist*, July 22, 2000.

## KEY ISSUES AND RECOMMENDATIONS

Many investor relations practitioners are members of the Canadian Investor Relations Institute and adhere to its guidelines against pressuring analysts in any way. These guidelines are voluntary and there remain some investor relations professionals and other senior officers of companies who do try to pressure analysts through the possible restriction of analysts' access to company information. This practice is clearly inappropriate and we believe that this should be addressed by the board of directors in a company's communications policy.

**31. We recommend that the Joint Committee on Corporate Governance (the Saucier Committee)<sup>23</sup> consider, as part of the corporate governance responsibility of a public company's board, the need for the development and review of a communications policy that addresses how the company's management interacts with analysts and the public, and how the company avoids selective disclosure.**

We do not think it is in the interest of companies to put pressure on analysts whether it is subtle or otherwise. In monitoring the communications policy of a company the board of directors should make certain that this issue is addressed and ensure that this type of pressure does not occur. Undertaking this activity is central to the mandate of the board of directors of any corporation, and is extremely important.

We commend the Canadian Investor Relations Institute (CIRI) for its recently issued Model Disclosure Policy,<sup>24</sup> prepared to assist its members in developing written disclosure policies. With regard to conference calls, the policy notes, among other things:

“Conference calls will be held for quarterly earnings and major corporate developments, whereby discussion of key aspects is accessible simultaneously to all interested parties, some as participants by telephone and others in a listen-only mode by telephone or via a webcast over the Internet. The call will be preceded by a news release containing all relevant material information ... The Company will provide advance notice of the conference call and webcast by issuing a news release announcing the date and time and providing information on how interested parties may access the call and webcast.”

The Committee endorses this policy and concurs with the need to ensure that information is available simultaneously to all interested parties. The CIRI Model Disclosure Policy also discusses a company's contacts with analysts, and recommends a process for reviewing analyst draft reports and models. The model policy states that a company should not provide analyst reports through any means but may post

<sup>23</sup> “Joint Committee on Corporate Governance” chaired by Guylaine Saucier, established mid-2000, with the interim report published in March, 2001 and the final report due for publication in late 2001.

<sup>24</sup> Canadian Investors Relations Institute. E-mail: [enquiries@ciri.org](mailto:enquiries@ciri.org)

on its website a complete list of all the investment firms and analysts who provide research coverage on the company.

**32. We recommend that public companies include the media and investors in analyst meetings and conference calls, thereby avoiding the risk of selective disclosure.**

#### **4.80 THE IMPORTANCE OF EDUCATION IN THE MARKETPLACE**

Different kinds of investors have different skills and different needs. Large institutional investors are in the business of investing enormous portfolios and have full-time staff with the expertise to analyze stocks on their own. Retail investors spend varying amounts of time on investment research before they buy or sell and may or may not have the expertise to analyze financial statements and the time to assemble continuous disclosure records and information. In between are those sophisticated individual investors and smaller institutional investors who do understand the market and readily access many different types of market information but do not have the resources to retain their own analysts and therefore often rely on sell-side analysis. While we have considered the needs of all investors, the Committee has gravitated towards concern for retail and small institutional investors. We believe the implementation of our recommendations will provide benefits to all investors and provide them with the information they need to assess analytical information in the marketplace.

Nevertheless, our concern does not change the fact that investors themselves are ultimately responsible for their investment decisions. It is up to investors to obtain all of the information that they need to make good investment decisions and to use all the information that is available. Investors need to understand the role of the analyst; to read research recommendations carefully; and to understand that most analysts work hard to maintain their analytical independence and to balance conflict, although the realities of the marketplace make this difficult to achieve in some instances.

**33. We recommend that securities regulators and the self-regulatory organizations work together to foster an understanding of research analysis, analyst recommendations and the role of analysts in the securities industry by providing education to investors and the public within existing educational programs.**

Different kinds of investors have different skills and different needs.

Investors themselves are ultimately responsible for their own investment decisions.

KEY ISSUES AND RECOMMENDATIONS

Investors need to understand the role of the analyst.

It is of interest to note that Arthur Levitt, former chairman of the US Securities and Exchange Commission, has urged more spending on investor education “which is much less expensive and onerous than regulations.”<sup>25</sup>

Ultimately, in order to make better investment decisions, investors need to understand how the market works and the role that analysts and analysis play in the marketplace. We believe that the recommendations we have proposed together with a better informed investor will contribute to the integrity of the capital market.

<sup>25</sup> “Levitt’s Legacy: An SEC chief who actually was a friend of the small investor looks back,” *Barron’s*, January 29, 2001.



## 5.0 CONCLUSIONS

### CONCLUSIONS

Analysts play an important and fundamental role in the capital markets and their work is of value to both institutional and retail investors. Analysts have the responsibility to operate effectively, competently and to the highest ethical standards to preserve the integrity of the market place. To be able to achieve this, they require a work environment in which conflicts are identified and managed and where the independence of research is valued.

Many Canadian analysts are highly regarded and respected. The Committee's examination of analysts' practices, standards of conduct and supervision did, however, indicate that there are valid investor concerns about analysts' practices, particularly concerning the objectivity and independence of sell-side research reports and recommendations. On the one hand, many sell-side analysts act independently and manage conflicts well within their firms. On the other, there is a widespread perception, and in some cases strong evidence, that independence of research is sometimes lacking and that recommendations are sometimes based on the financial interests of the dealer firm rather than on the delivery of independent research to investors. In addition, while some large institutional investors discount much of the sell-side research as biased and essentially marketing material, many institutional investors

Analysts play an important and fundamental role in the capital markets.

## CONCLUSIONS

It is important to clarify the role of analysts in the market and establish some standards of practice and disclosure.

still use sell-side research and value the research information and products.

The Committee believes that changes must be made. We believe it is very important both to clarify the role of analysts in the market, and to establish some standards of practice and disclosure to ensure that investors' interests are protected. While our recommendations apply to all analysts, we believe that the conflicts of interest and pressures that sell-side analysts face are the greatest. We have therefore chosen to target many of our recommendations at sell-side analysts in particular.

Throughout our deliberations, we have been guided by the objectives that our recommendations should achieve the following:

- Promote the fair treatment of all investors, especially retail and small institutional investors, in part by making it easier for them to evaluate the objectivity of analysts' reports.
- Enable analysts to function as independently as possible within a firm, and produce objective, independent, opinions without suffering detrimental career consequences if these opinions do not support the firm's business at all times.
- Contribute to improvements in the efficiency and integrity of the capital market, thereby increasing international respect for the Canadian securities industry. We want Canada to be a leader, not a laggard in the field.

In developing our recommendations, we have chosen the least intrusive option where possible, favoring mandatory disclosure over regulation. In those cases where serious conflicts cannot be managed by disclosure we have recommended certain prohibitions. This is important as in some respects we see the analyst as the "ham in the sandwich" between the issuer and the dealer, and the analyst should be able to maintain a commitment to ethics and high standards of practice.

We have also attempted to balance the benefits against additional costs. Since the majority of the recommendations focus on disclosure, we do not think they will add significantly to the costs of market participants.

The recommendations proposed within this report require implementation to have any effect on the marketplace. We urge all of the SROs to work expeditiously to implement these recommendations and to work with other groups to ensure that the changes are implemented throughout Canada. One of the commentators suggested that the Committee expand its mandate to include implementation. While we are anxious to see the recommendations implemented swiftly,

it is up to the SROs, and more specifically the IDA and the CSA, to ensure that these recommendations are acted upon in a timely fashion. The role of analysts in the marketplace is also of great interest in the United States. We have received comments from several US-based dealers. We therefore also urge the SROs to work with US regulators to harmonize implementation plans.

We are pleased to have undertaken this review at a time when the marketplace was so focused on analysts and their place in the marketplace. We believe that implementation of these recommendations will go a long way to addressing investors' concerns and will contribute significantly to the confidence investors have in market information.

It is up to the SROs, and more specifically the IDA and the CSA, to ensure that these recommendations are acted upon in a timely fashion.

**APPENDIX I****SUBMISSIONS RECEIVED BY THE COMMITTEE**

Association for Investment Management and Research  
Atco Ltd. & Canadian Utilities Limited  
Bowridge Resource Group Inc.  
Cameco Corporation  
Canada Trust  
Canadian Council of Professional Geoscientists  
Canadian Investor Relations Institute  
Canadian National  
Canadian Securities Institute  
Canadian Shareowners Association  
Institute of Corporate Directors  
Magna Vista Capital Management Inc.  
Nesbitt Burns  
Petro-Canada  
Prospectors & Developers Association of Canada  
RBC Dominion Securities  
University of Toronto

**PRESENTATIONS MADE TO THE COMMITTEE**

Alberta Stock Exchange  
Altamira Financial Services Ltd.  
Association for Investment Management and Research  
BankWorks Trading Inc.  
Canadian Advocacy Council  
Canadian Council of Professional Geoscientists  
Canadian Investor Relations Institute  
Canadian Shareholders Association  
Griffiths McBurney and Partners  
Institute of Corporate Directors  
Investment Dealers Association  
KPA Advisory Services Ltd.  
Merrill Lynch Canada Ltd.  
OMERS  
Ontario Securities Commission (2)  
Pension Investment Association of Canada  
Prospectors & Developers Association of Canada  
RBC Dominion Securities Inc.  
Ross Smith Energy Group  
Scotia Capital  
ScotiaMcLeod  
Toronto Society of Financial Analysts  
Toronto Stock Exchange  
US Securities and Exchange Commission  
University of Toronto  
Vancouver Stock Exchange  
Yorkton Securities Inc.  
York University

**COMMENTS ON THE DRAFT REPORT WERE RECEIVED FROM:**

AIM Funds Management Inc.  
Ambachtsheer Letter, The  
Association of Professional Geoscientists of Ontario  
Association for Investment Management and Research  
Canadian Council of Professional Engineers  
Canadian Council of Professional Geoscientists  
Canadian Investor Relations Institute  
Canadian Shareowner  
Centre for Corporate & Public Governance, The  
CIBC World Markets  
Edward Jones (Canada)  
Fawcett, John  
Global Securities Corporation  
Halton Association of Geoscientists  
Hill, Derek  
Independent Equity Research Corp.  
Jones, Gable & Company Limited  
Maison Placements Canada Inc.  
Morgan Stanley Canada Limited  
Prospectors and Developers Association of Canada  
Raymond James Ltd.  
Ready, Jack  
Roscoe Postle Associates Inc.  
Scotia Capital  
Sprott Securities Inc.  
TD Securities Inc.  
Wakefield, Don  
Waychison, Mark

**RECOMMENDATIONS RELATING TO ANALYSTS  
CONTAINED IN THE MINING STANDARDS TASK  
FORCE FINAL REPORT, JANUARY 1999.**

The Task Force recommended that:

- Canadian self-regulatory organizations form an industry committee to examine the standards of supervision of analysts' activities and interpretations of the Association for Investment Management and Research's Code of Ethics and Standards of Professional Conduct, with the objective of establishing minimum industry standards governing the supervision and conduct of all research analysts.
- The Toronto Stock Exchange require its member firms to ensure that their analyst employees distinguish clearly in their reports and recommendations between information disclosed by a company and the analysts' own opinions and projections.
- The Toronto Stock Exchange require its member firms to ensure that their analyst employees disclose their qualifications and experience, and state the basis of their calculations and projections, in all research reports that include comment on the merits of a mineral property.
- The Toronto Stock Exchange require its member firms, through their compliance functions, to ensure that their analysts comply with the "Code of Ethics" and the "Standards of Professional Conduct" established by the Association for Investment Management and Research, whether or not they are members of that organization.
- The Toronto Stock Exchange require its member firms to ensure, through their compliance functions, that their mining analyst employees are knowledgeable of the provisions of National Instrument 43-101 and the TSE disclosure standards, and employ in their research reports and presentations the terminology and standards of disclosure that mineral exploration and mining companies are required to use in disclosing the results of exploration and development programs, mining operations and the reporting of resources and reserves, as required by Canadian securities regulatory authorities and stock exchanges.
- The Toronto Stock Exchange, as part of its oversight of members' activities, selectively monitor analysts' reports to ensure that the terminology and standards of disclosure required by Canadian securities regulatory authorities and stock exchanges are employed in the analysts' reports.
- The Toronto Stock Exchange require its member firms to ensure that their analysts report to the Market Surveillance Department of the TSE, or the appropriate securities regulatory authorities, any material breach of disclosure requirements by a mineral exploration or mining company.
- The Toronto Stock Exchange require its member firms to ensure that their analysts disclose any conflicts of interest in their research reports. Research reports should disclose whether the analyst, or anyone in the research group, holds securities in the company being reviewed, including the amount of securities held. The research report should also disclose whether anyone in the member firm is an insider of the company being reviewed.

**AIMR CODE OF ETHICS AND STANDARDS  
OF PROFESSIONAL CONDUCT**

*(reprinted with permission)*

**THE CODE OF ETHICS**

Members of the Association for Investment Management and Research shall:

- Act with integrity, competence, dignity, and in an ethical manner when dealing with the public, clients, prospects, employers, employees, and fellow members.
- Practice and encourage others to practice in a professional and ethical manner that will reflect credit on members and their profession.
- Strive to maintain and improve their competence and the competence of others in the profession.
- Use reasonable care and exercise independent professional judgment.

**STANDARDS OF PROFESSIONAL CONDUCT**

**Standard I: Fundamental Responsibilities**

Members shall:

- a) Maintain knowledge of and comply with all applicable laws, rules, and regulations (including AIMR's Code of Ethics and Standards of Professional Conduct) of any government, governmental agency, regulatory organization, licensing agency, or professional association governing the members' professional activities.
- b) Not knowingly participate in or assist any violation of such laws, rules, or regulations.

**Standard II: Relationships with and Responsibilities to the Profession**

**A. Use of Professional Designation.**

- I. AIMR members may reference their membership only in a dignified and judicious manner. The use of the reference may be accompanied by an accurate explanation of the requirements

that have been met to obtain membership in these organizations.

2. Those who have earned the right to use the Chartered Financial Analyst designation may use the marks "Chartered Financial Analyst" or "CFA" and are encouraged to do so, but only in a proper, dignified, and judicious manner. The use of the designation may be accompanied by an accurate explanation of the requirements that have been met to obtain the right to use the designation.
3. Candidates in the CFA Program, as defined in the AIMR Bylaws, may reference their participation in the CFA Program, but the reference must clearly state that an individual is a candidate in the CFA Program and cannot imply that the candidate has achieved any type of partial designation.

**B. Professional Misconduct.**

- I. Members shall not engage in any professional conduct involving dishonesty, fraud, deceit, or misrepresentation or commit any act that reflects adversely on their honesty, trustworthiness, or professional competence.
2. Members and candidates shall not engage in any conduct or commit any act that compromises the integrity of the CFA designation or the integrity or validity of the examinations leading to the award of the right to use the CFA designation.

**C. Prohibition against Plagiarism.**

Members shall not copy or use, in substantially the same form as the original, material prepared by another without acknowledging and identifying the name of the author, publisher, or source of such material. Members may use, without acknowledgement, factual information published by recognized financial and statistical reporting services or similar sources.

**Standard III: Relationships with and Responsibilities to the Employer**

**A. *Obligation to Inform Employer of Code and Standards.***

Members shall:

1. Inform their employer in writing, through their direct supervisor, that they are obligated to comply with the Code and Standards and are subject to disciplinary sanctions for violations thereof.
2. Deliver a copy of the Code and Standards to their employer if the employer does not have a copy.

**B. *Duty to Employer.***

Members shall not undertake any independent practice that could result in compensation or other benefit in competition with their employer unless they obtain written consent from both their employer and the persons or entities for whom they undertake independent practice.

**C. *Disclosure of Conflicts to Employer.***

Members shall:

1. Disclose to their employer all matters, including beneficial ownership of securities or other investments, that reasonably could be expected to interfere with their duty to their employer or ability to make unbiased and objective recommendations.
2. Comply with any prohibitions on activities imposed by their employer if a conflict of interest exists.

**D. *Disclosure of Additional Compensation Arrangements.***

Members shall disclose to their employer in writing all monetary compensation or other benefits that they receive for their services that are in addition to compensation or benefits conferred by a member's employer.

**E. *Responsibilities of Supervisors.***

Members with supervisory responsibility, authority, or the ability to influence the conduct of others shall exercise reasonable supervision over those subject to their supervision or authority to prevent any violation of applicable statutes, regulations, or provisions of the Code and Standards. In so doing, members are entitled to rely on reasonable procedures to detect and prevent such violations.

**Standard IV: Relationships with and Responsibilities to Clients and Prospects**

**A. *Investment Process.***

**A.1 Reasonable Basis and Representations.**

Members shall:

- a) Exercise diligence and thoroughness in making investment recommendations or in taking investment actions.
- b) Have a reasonable and adequate basis, supported by appropriate research and investigation, for such recommendations or actions.
- c) Make reasonable and diligent efforts to avoid any material misrepresentation in any research report or investment recommendation.
- d) Maintain appropriate records to support the reasonableness of such recommendations or actions.

**A.2 Research Reports. Members shall:**

- a) Use reasonable judgement regarding the inclusion or exclusion of relevant factors in research reports.
- b) Distinguish between facts and opinions in research reports.
- c) Indicate the basic characteristics of the investment involved when preparing for public distribution a research report that is not directly related to a specific portfolio or client.

A.3 Independence and Objectivity. Members shall use reasonable care and judgment to achieve and maintain independence and objectivity in making investment recommendations or taking investment action.

**B. Interactions with Clients and Prospects.**

B.1 Fiduciary Duties. In relationships with clients, members shall use particular care in determining applicable fiduciary duty and shall comply with such duty as to those persons and interests to whom the duty is owed. Members must act for the benefit of their clients and place their clients' interests before their own.

B.2 Portfolio Investment Recommendations and Actions. Members shall:

- a) Make a reasonable inquiry into a client's financial situation, investment experience, and investment objectives prior to making any investment recommendations and shall update this information as necessary, but no less frequently than annually, to allow the members to adjust their investment recommendations to reflect changed circumstances.
- b) Consider the appropriateness and suitability of investment recommendations or actions for each portfolio or client. In determining appropriateness and suitability, members shall consider applicable relevant factors, including the needs and circumstances of the portfolio or client, the basic characteristics of the investment involved, and the basic characteristics of the total portfolio. Members shall not make a recommendation unless they reasonably determine that the recommendation is suitable to the client's financial situation, investment experience, and investment objectives.
- c) Distinguish between facts and opinions in the presentation of investment recommendations.

d) Disclose to clients and prospects the basic format and general principles of the investment processes by which securities are selected and portfolios are constructed and shall promptly disclose to clients and prospects any changes that might significantly affect those processes.

B.3 Fair Dealing. Members shall deal fairly and objectively with all clients and prospects when disseminating investment recommendations, disseminating material changes in prior investment recommendations, and taking investment action.

B.4 Priority of Transactions. Transactions for clients and employers shall have priority over transactions in securities or other investments of which a member is the beneficial owner so that such personal transactions do not operate adversely to their clients' or employer's interests. If members make a recommendation regarding the purchase or sale of a security or other investment, they shall give their clients and employer adequate opportunity to act on their recommendations before acting on their own behalf. For purposes of the Code and Standards, a member is a "beneficial owner" if the member has

- a) a direct or indirect pecuniary interest in the securities;
- b) the power to vote or direct the voting of the shares of the securities or investments;
- c) the power to dispose or direct the disposition of the security or investment.

B.5 Preservation of Confidentiality. Members shall preserve the confidentiality of information communicated by clients, prospects, or employers concerning matters within the scope of the client-member, prospect-member, or employer-member relationship unless a member receives

information concerning illegal activities on the part of the client, prospect, or employer.

**B.6 Prohibition against Misrepresentation.**

Members shall not make any statements, orally or in writing, that misrepresent

- a) the services that they or their firms are capable of performing;
- b) their qualifications or the qualifications of their firm;
- c) the member's academic or professional credentials.

Members shall not make or imply, orally or in writing, any assurances or guarantees regarding any investment except to communicate accurate information regarding the terms of the investment instrument and the issuer's obligations under the instrument.

**B.7 Disclosure of Conflicts to Clients and Prospects.**

Members shall disclose to their clients and prospects all matters, including beneficial ownership of securities or other investments, that reasonably could be expected to impair the members' ability to make unbiased and objective recommendations.

**B.8 Disclosure of Referral Fees.** Members shall disclose to clients and prospects any consideration or benefit received by the member or delivered to others for the recommendation of any services to the client or prospect.

**Standard v: Relationships with and Responsibilities to the Public**

***A. Prohibition against Use of Material Nonpublic Information.***

Members who possess material nonpublic information related to the value of a security shall not trade or cause others to trade in that security if such trading would breach a duty or if the information was misappropriated or

relates to a tender offer. If members receive material nonpublic information in confidence, they shall not breach that confidence by trading or causing others to trade in securities to which such information relates. Members shall make reasonable efforts to achieve public dissemination of material nonpublic information disclosed in breach of a duty.

***B. Performance Presentation.***

1. Members shall not make any statements, orally or in writing, that misrepresent the investment performance that they or their firms have accomplished or can reasonably be expected to achieve.
2. If members communicate individual or firm performance information directly or indirectly to clients or prospective clients, or in a manner intended to be received by clients or prospective clients, members shall make every reasonable effort to assure that such performance information is a fair, accurate, and complete presentation of such performance.

## GLOSSARY OF TERMS

**Adviser:**

A person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others as to the investing in or the buying or selling of securities. (Ontario Securities Act 2000)

**AIMR:**

The Association for Investment Management and Research is an international non-profit organization based in the United States. Its members and candidates consist of investment analysts, portfolio managers and other investment decision-makers employed by investment management firms, banks, broker-dealers, investment company complexes and insurance companies. AIMR's mission is to serve investors through its membership by providing global leadership in education on investment knowledge, sustaining high standards of professional conduct, and administering the Chartered Financial Analyst designation program.

**Associate:**

Where used to indicate a relationship with any person or company means,

- a) any company of which such person or company beneficially owns, directly or indirectly, voting securities carrying more than 10% of the voting rights attached to all voting securities of the company for the time being outstanding,
- b) any partner of that person or company,
- c) any trust or estate in which such person or company has a substantial beneficial interest or as to which such person or company serves as trustee or in a similar capacity,
- d) any relative of that person who resides in the same home as that person,
- e) any person who resides in the same home as that person and to whom that person is married, or any person of the opposite sex or the same sex who resides in the same home as that person and with whom that person is living in a conjugal relationship outside marriage, or

- f) any relative of a person mentioned in clause (e) who has the same home as that person. (Ontario Securities Act 2000)

**Broker:**

A securities firm or a registered individual affiliated with one. Brokers are the link between investors and the stock market.

**Conflict of Interest:**

The words "conflict" or "conflicts" refer to a conflict of interest or conflicts of interest, unless otherwise noted. Conflicts of interest may be potential, perceived or real, but for the purposes of this report, the Committee addresses them all as conflicts of interest.

**Equities:**

Common and preferred stocks, which represent a share in the ownership of a company.

**Hagg Report:**

Report of the Joint Securities Industry Committee on Conflicts of Interest. John A. Hagg, Chairman, September 1997.

**Independent Analyst:**

Self-employed, not employed by buy-side or sell-side firms.

**Investment Dealer, Dealer, Dealer Firm:**

Firm that is registered to trade in securities and act as agent or principal in primary market distribution or in secondary market trading as well as investing its own capital in the market. Investment dealers are members of the IDA and many are also members of and/or participating organizations in stock exchanges.

**IPO:**

Initial Public Offering, a company's first issue of shares to the general public.

**Issuer:**

Public company

**Material Information:**

Any information relating to the business and affairs of a company that results in, or would reasonably be expected to result in, a significant change in the market price or value of the company's securities.

**Member, Member Firm:**

See Investment Dealer

**Mining Standards Task Force Final Report:**

"Setting New Standards. Recommendations for Public Mineral Exploration and Mining Companies." Published January 1999 by Toronto Stock Exchange and Ontario Securities Commission.

**NASD Regulation Inc.:**

The regulatory arm of NASD, that is not owned by and is completely separate from NASDAQ.

**Ontario Securities Commission:**

Government agency that administers the Securities Act (Ontario) and regulates capital markets.

**Pro Group:**

The Pro Group is a term to describe a firm and its staff who form a non-arms length group and includes both individually, and as a group, the member firm (of a self-regulatory organization), employees of the member and partners, directors and officers of the member and their associates and affiliates, as defined in proposed IDA By-law 29.15(a) and TSE Section 1.01. The proposed rules grant the SROs the discretion to exclude a party from the Pro Group if it is determined that the party is acting at arm's length of the member; as well as the discretion to include a party in the Pro Group where that party is not acting at arm's length of the member. The Pro Group as defined in the Hagg Report in 1997 did not include all employees of member firms.

**Registered Dealer:**

See Investment Dealer

**Regulation FD:**

Regulation Fair Disclosure introduced by the SEC in 2000.

**Remuneration:**

Includes all forms of payment for services.

**Research Report:**

Any written report, be it newsletter or dealer firm's analyst's report, containing a recommendation with regard to buying, holding or selling a stock or security.

**Restricted List:**

A list of securities that are restricted from trading for a specific length of time to ensure a conflict of interest does not develop.

**Saucier Committee:**

Joint Committee on Corporate Governance, chaired by Guylaine Saucier, and established by the Canadian Institute of Chartered Accountants, the Canadian Venture Exchange and the Toronto Stock Exchange in mid-2000. Final Report expected in fall 2001.

**Self-regulatory Organization (SRO):**

An organization recognized by securities administrators as having powers to establish and enforce industry regulations to protect investors and to maintain fair, equitable and ethical practices in the securities industry.

**Short Selling:**

The sale of securities that the seller does not own.



