

November 8, 2004

James E. Twiss  
Chief Policy Counsel  
Market Policy and General Counsel's Office  
Market Regulation Services  
Suite 900  
P.O. Box 939  
145 King Street West  
Toronto, Ontario.  
M5H 1J8

Dear Sir:

**Re: Amendments Respecting Trading During Certain Securities Transactions**

This letter is submitted in response to the request for comments from Market Regulation Services Inc. ("RS") published September 10, 2004. National Bank Financial ("NBF") supports the initiative of RS to clarify the existing rules and make amendments where necessary, to provide guidance to Participating Organizations ("PO"). The comments which follow are provided in the same spirit, to ensure greater clarity and guidance for market participants.

The numbering of our comments follows the numbering in the September 10, 2004 document.

**Rule 1.1 Definitions "dealer-restricted person" (b).**

Part (b) of the definition of a "dealer-restricted person" defines entities of a PO to which the definition does not apply. These exempting provisions apply to separate and distinct departments or divisions of a PO provided that:

- the PO maintains an information wall between employees participating in the related transaction and other employees of the PO who are not involved in the transaction;
- the PO does not solicit client orders;
- and the PO does not engage in market making and/or proprietary trading.

NBF believes that its proprietary trading operation meets the requirements of the safe harbour provision for the following reasons:

The NBF proprietary trading group is a separate department which has its own independent management, structure and physical location. NBF has deliberately located its proprietary trading group behind its own Information Wall so that it is isolated from both Institutional Equity activities and Corporate and Investment Banking. The investment decisions for the proprietary trading group are independent of the other businesses of NBF.

Market stabilization and market balancing activities are not conducted for NBF by the proprietary trading group. These activities are the responsibility of the institutional equity group, which is managed independently and located on a separate floor from the proprietary trading group. The focus, purpose and activities of the proprietary trading group, whose activities are not client focused, are entirely different from the institutional equity group whose primary purpose is to execute orders for clients.

The NBF proprietary trading group does not deal with clients in any manner, nor does it engage in market making or proprietary trading.

As a result of the NBF concludes that the activities conducted by its proprietary trading group do not meet the concept of proprietary trading as used by RS in this amendment. Market stabilization, and market balancing or any other type of trading related to a restricted security are not conducted by the NBF proprietary trading group.

### **Rule 1.1 Definitions “restricted period”**

The proposed definition of the restricted period for a dealer restricted person commences on the date that the PO enters into an agreement or reaches an understanding to participate in a public distribution of securities. The knowledge of such an agreement or understanding is limited to a small select group of corporate and investment banking professionals who, by definition, are behind the Information Wall. The purpose of the Information Wall is to allow a PO to conduct its normal business activities while in possession of material non public information.

It is unclear to NBF what actions RS expects of PO’s when an understanding to participate in a public distribution occurs but before any public announcement is made.

Normal industry practice is to place the subject security on a Grey List to allow the PO to monitor trading and to determine whether there is any breach of the Information Wall. However, broad public dissemination of a proposed distribution or other event is not made either within the PO or to outside parties until a press release by the issuer has been issued. This avoids selective disclosure, maintains the integrity of the Information Wall and creates a level playing field.

It is unclear to NBF from the definition what other actions RS expects of a PO. Additional guidance should be given on this issue.

## **(6) Compilations and Industry Research**

It is unfortunate that the amendments do not allow the publication of research reports, especially for a highly-liquid security when such securities meet the definition of a restricted security. One of the main reasons why the Investment Dealers Association of Canada (“IDA”) implemented Policy 11 in February 2004 was to ensure that the research function remain separate from the other business activities of a dealer. The intent of Policy 11 was to ensure the independence of the research function and to provide a dealer’s clients with impartial information. The goal of the requirement in Part (6) seems to negate the intention of IDA Policy 11, especially for highly liquid securities.

Furthermore, Part (6) allows limited publication of research provided that it is in a publication that is distributed with reasonable regularity and that includes as its subject matter a substantial number of other issuers. NBF publishes, as do most other large dealers, monthly and quarterly synopsis of the securities on which it provides research. Such reports are summaries of the extensive reports that NBF has published the previous month or quarter and provide only a brief summary of the conclusions reached. NBF would not recommend that its clients base their investment decisions solely on such summaries; rather, it would refer its clients to the detailed reports that describe in full detail how the conclusions reached were arrived at.

Part (6) of the amendments would allow clients to have the benefit of a research analyst’s conclusions without having the benefit of how those conclusions were reached since only summaries are allowed. In this instance the proposed amendments would hinder the ability of the client to make a knowledgeable decision. Furthermore, the restriction imposed on publishing a complete research report will impose greater pressure on the research analyst to reveal how he or she arrived at the conclusion published in the monthly or quarterly summary if those conclusions are different from the previous report. The ability to publish conclusions without being able to provide details on how those conclusions were reached severely impacts the ability of a research analyst to respond to client inquiries. Without the ability to publish and disseminate to all clients at the same time research analysts may be accused of selective disclosure.

### **Policy 7.7 Part 4 – Research**

Policy 7.7 Part 4 does little to clarify what are permitted activities during certain securities transactions. The first paragraph of Part 4 – Research states that a dealer may not publish research where “... the dealer or the analyst covering the issuer of the offered security or any other representative of the dealer is in possession of material information regarding the issuer that has not been publicly disclosed.” NBF agrees that when a research analyst is in possession of non material information that has not been disclosed then he or she should not use such information to publish research. This is one of the major reasons that dealers maintain Information Walls to ensure that research analysts do not receive such undisclosed material information. By maintaining an Information Wall, dealers are able to conduct their corporate and investment banking activities behind the Information Wall without the other areas of a dealer, such as sales, trading and research,

being aware of such information. This allows dealers to continue their various activities based on an effective Information Wall.

NBF takes exception to the requirement that research publication must cease whenever NBF or any one of its representatives is in possession of material non public information. Such a requirement is contrary to the concept of an Information Wall described above. A literal application of the policy would require that whenever the corporate and investment banking department initiates discussions with issuers that may or may not result in an engagement that all research publication cease while the issue is decided. In practice this would mean that a PO had to research restrict all the issuers that are listed on its Grey List. The cessation of research in such an instance provides incomplete and potentially misleading information to the marketplace that would result in great confusion to clients. NBF believes that this is not the intention of the amended rules and suggests that greater clarification be provided to reflect dealer practices.

The second paragraph of Policy 7.7 Part 4 provides clarification of the circumstances when a dealer may publish an opinion or recommendation relating to the issuer of a restricted security. NBF understands the requirement that such publication be on a regular basis. As stated above all dealers who publish research regularly publish monthly or quarterly summaries. These summaries include tables listing the most relevant information relating to an issuer's earnings and revenues and the research analyst's recommendation and target price. If such summary publications are allowed for securities which are a restricted security then the research analyst may wish to change his recommendation and or target because of the transaction which caused the security to be initially restricted. Thus the summary publication will contain more current information in a condensed form without all the necessary details to allow clients to make an informed investment decision.

By allowing PO's to publish research reports on restricted securities that meet the definition of a highly liquid security, clients would receive complete information upon which to base their investment decisions.

Overall, NBF believes that Part (6) and Policy 7.7 Part 4 restricts transparency of information needed by clients to make informed investment decisions. NBF believes that Part (6) and Policy 7.7 Part 4 should be amended to allow dealers to publish research on highly-liquid securities.

NBF appreciates the opportunity to provide comment on the RS initiative to provide greater clarity and guidance to POs.

Questions relating to the issues raised in this letter should be addressed to the writer at 416 869-6422

Sincerely,

Gerhard Wetzel  
Managing Director Compliance

cc: Cindy Petlock, OSC

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