INVESTMENT DEALERS ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DES COURTIERS EN VALEURS MOBILIÈRES

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To: All Chief Financial Officers, IDA Member Firms **September 11, 1998**
Panel Auditors, IDA Jurisdiction Firms **C-122**

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Rules implementing the Recommendations of The Joint Securities Industry on Conflicts of Interest

On September 1, 1998, the Association issued a Notice to Members announcing partial early implementation of Association rules implementing the recommendations of the Joint Securities Industry on Conflicts of Interest. This Bulletin provides guidance to Members in complying with partial early implementation.

What is partial early implementation?

The SROs will enforce two of the new rules on the basis of the existing definition of 'pro' in current SRO rules. These rules are the **client priority rule** and the abridgement of **hold period rule**.

Why not implement all rules at the same time?

Systems development will be required to collect and calculate data based on the new definition of 'pro group'. The pro group definition is the basis for most of the rules.

Client Priority

Clients will be given priority over pros for issuances of securities via private placement.

Who gets priority?

The rule requires priority to be given to existing eligible clients – those are clients who have already entered into a relationship with the Member either by opening an account or seeking advice from the Member or its employees and for whom such a purchase would be suitable taking into consideration the client's investment objectives, risk tolerance, financial situation and eligibility under securities legislation to take advantage of the prospectus exemption under which the private placement is offered.

When does client priority apply?

When the Member is the underwriter, agent, advisor or member of a selling group for an issuer OR where the pros in the Member

own 20% or more of the issuer's issued and outstanding securities (as calculated after the issuance).

What steps does the Member have to take to disseminate information to clients? What are reasonable efforts?

The Member must make reasonable efforts to inform existing eligible clients of the availability of the private placement. The Member should take into account the size of its eligible client list, the nature of the issue, and the effectiveness of its communication links with clients. The Member should communicate by way of email, press release, newswire, fax or phone the existence of the private placement to eligible clients and allow them sufficient time to respond. The response time will depend on the number of eligible clients, the profile of the issuer and the means of communication.

The nature of the prospectus exemption under which the private placement is being made must also be taken into account in disseminating information. If the prospectus exemption prohibits public solicitation of the private placement, then other means of communication must be employed.

The Association expects that Members will determine what steps should be taken to inform eligible clients of the availability of the private placement.

Members are expected to have written policies and procedures in place to fulfil this requirement; these procedures shall include:

- development and maintenance of a list of eligible clients
- development of a protocol to communicate the information by telephone, fax, mail or electronic means
- issuance by the issuer of a press release announcing availability and price of the private placement
- establishment of a suitable time period for clients to receive and act on the information
- adequately informing its employees of the policies and procedures to be followed before a private placement can be distributed

The Member must document its attempts to solicit client interest in private placement issuances and must retain documentation to evidence those efforts for at least two years after the closing date of the issuance.

Hold Periods

When will abridgement of hold periods not be permitted?

The hold period restricting the resale of private placement securities cannot be abridged where pros in the Member firm hold 20% or more of the issuer's issued and outstanding securities. It is the Member's responsibility to show that pros do not own this 20% when requesting an abridgement.

When will abridgement of hold periods be permitted?

Even where pros own 20% or more of the issuer's issued and outstanding securities, the hold period may be abridged if the private placement issuance was accepted by an exchange and the private placement securities were sold for a price greater than 80% of the public offering price or where the securities are being disposed of pursuant to an arm's length take-over or merger and the exchange grants consent.

Members are advised to review this rule with the exchange or securities commission being asked to grant the abridgement.

Any questions regarding this Interpretation Bulletin should be directed to:

Keith Rose, Vice-President, Regulatory Policy (416) 943-6907

Jennifer Elliott, Legal and Policy Counsel (416) 943-6994

Please distribute to all interested parties in your firm

Joint Securities Industry Committee On Conflicts of Interest – Implementation of Recommendations

The Joint Securities Industry Committee on Conflicts of Interest released its final report (the "Report") on September 18, 1997. **This Notice to Members implements the first stage of the Report's recommendations: rules requiring client priority for the issuance of securities via private placement and restrictions on the abridgement of hold periods**.

The SROs have drafted rules implementing the Report's recommendations. These rules have been approved by the Boards of each of The Alberta Stock Exchange, the Montreal Exchange, The Toronto Stock Exchange, the Vancouver Stock Exchange and the Investment Dealers Association and are currently being considered for approval by the Canadian Securities Administrators.

The rules include: (1) a requirement to aggregate the holdings of a 'pro group' in all securities and to disclose those holdings in trade confirmations, research reports and monthly reports compiled by the exchanges; (2) the establishment of client priority rules for private placements so that a private placement must be sold to eligible clients before being offered to Member employees; (3) a prohibition against the abridgement of those hold periods where the pro group holds 20% or more of the issued and outstanding securities of the issuer subject to the hold period; and (4) a requirement to engage an independent underwriter when the pro group owns 20% of the securities of an issuer or exercises influence over the issuer or is influenced by the issuer.

The Executive Committees of the SROs have indicated their expectation that the Report's recommendations be implemented in the meantime as soon as possible to the extent possible.The cornerstone of the Report's recommendations is the calculation and disclosure of pro group holdings. Calculation and disclosure will require a significant investment in technology and systems on the part of the SROs and the Members. The SROs are developing a central system to receive data on pro group holdings from Members, provide on-going market capitalization data for companies listed on all Canadian exchanges, and calculate the percentage pro group holdings based on this data for the purposes of disclosure. Implementation of disclosure rules will be phased-in in consideration of the time needed to

develop these systems and the resources currently being devoted to Year 2000 systems issues.

The Association released a Member Bulletin on December 15, 1997 indicating that Members were encouraged to proceed with early implementation of the Report's recommendations, particularly the client priority, underwriting conflict of interest and hold period recommendations. **At this time, Members must begin compliance with the client priority and hold period rules.**

Client Priority:

The Association will now require Members to grant priority to clients in private placements where the Member is acting as underwriter, agent or advisor or where pros in the Member firm, hold 20% or more of the issued and outstanding securities of the issuer. The existing definition of 'pro' in SRO rules should be used in compliance with this requirement. Members must have in place procedures to ensure that in these circumstances,pros do not take up any portion of the private placement unless those securities have first been offered to eligible Member clients. Members must make a reasonable effort to inform existing, eligible clients of the availability of the private placement.

Hold Periods:

The exchanges will not allow securities held by pros in the Member firm and which are subject to a hold period to be qualifed for resale by subsequent prospectus where pros hold 20% or more of any class of voting or equity securities of the issuer unless the securities were issued pursuant to a private placement which was acceptable by an exchange and the issuance price of the private placement is greater than 80% of the public offering price.

The Association will continue to update Members on the progress of full-implementation of the rules.

Any questions on the above should be addressed to Keith Rose, Vice President, Regulatory Policy at (416) 943-6907.

Lyn M. Gilchrist
Association Secretary

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