BMO Nesbitt Burns

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**Re: REQUEST FOR COMMENTS:**

**RS Inc: Amendments Respecting Restrictions on Trading by a Participant During a Distribution and Restrictions on Trading During a Securities Exchange Take-Over Bid**
And
**OSC Proposed Rule 48-501—Trading During Distributions, Formal Bids and Share Exchange Transactions**

BMO Nesbitt Burns welcomes the opportunity to provide input on Market Regulations Services Inc.'s (RS) proposed amendments to the Universal Market Integrity Rules (UMIR) with respect to market stabilization and market balancing activities, proposed exemptions, and harmonization with the Ontario Securities Commission (OSC) proposed rule 48-501 governing the same activities.

In general, BMO Nesbitt Burns supports the efforts to provide amended UMIR and OSC rules that will more clearly delineate activities and provide exemptions within a robust regulatory framework. As an active market participant, we have concerns about some of the new definitions and the lack of detail for some of the proposed amendments. We elaborate in the discussion below.

**COMMENTS**

- **Definition of "dealer restricted person" and "issuer-restricted person"**

  The amended definition of "dealer restricted person" is too broad. For a financial conglomerate, the definition would be costly, onerous, and impossible to monitor.

  From our perspective, the definition of a "related entity of the dealer" appears to include any entity within the BMO Financial Group that is registered as a dealer or adviser and employees of such entities. For instance, the definition would include: BMO Investorline, Jones Heward Investment Counsel, Guardian Group of Funds, BMO Harris Investment Management Inc., and BMO Investments Inc (Mutual Funds). Currently, there is no requirement for non-dealer employees to hold their accounts at a designated dealer, therefore they cannot be monitored. Nor do we believe that it is appropriate for the definition to be so sweeping.

  The regulators should consider excluding "related entities" of a "dealer restricted person" from the definition if:

  1. the "related entity" is a separate and distinct organizational entity from the "dealer restricted person";
  2. the "related entity's" bids for, purchases of, and inducements to purchase securities in distribution were made in the ordinary course of its business; and
  3. the "dealer restricted person" maintained and enforced written policies and procedures designed to segregate the flow of information between the "dealer restricted person" and its related entities ("information barriers").

- **Definition of "highly-liquid security"**

  BMO Nesbitt Burns is in agreement with the proposed definition of a "highly-liquid security" and the exemptions that would apply to such a security. The proposed definition includes the components of Reg M that measure number of trades per day and average daily trading volume, but does not include Reg M's test for public float. We believe that the public float information is not as readily available, and does not provide significant additional value to the test for liquidity.

  In actual practice, we would expect that:

  - RS will be charged with the responsibility for maintaining the list
  - The list will be regularly updated (for example, weekly)
  - The list will be widely distributed and easily accessible
  - The list will be harmonized with Reg M (to the extent described above.)

- **Commencement of the restricted period**

  With respect to wide distributions, the requirement that the Exchange or QTRS be given two trading days notice is not consistent with current practice. Often the time frame for final details of how a trade will be executed is much less than two days. We are in concurrence that the Exchange or QTRS must be notified as soon as practicable that a wide distribution will be taking place.

- **Termination of the restricted period**

  BMO Nesbitt Burns seeks clarity with respect to when the selling process is considered to end and when stabilization arrangements are considered to have been terminated. Clearly, these factors have a great impact on when the Lead Manager of a deal can declare that the participants are out of distribution and hence price and trading restrictions no longer apply. Historically, three criteria have been required to be satisfied:

- Deal has been fully allocated (ie fully sold)
- A receipt for the final prospectus has been obtained
- Stabilization arrangements have been terminated. Short covering is not considered to be part of stabilization.

According to the UMIR interpretation discussion (page 27, 1.2(6)(a) (i)), reference is made to the end of the selling process requiring not only a final receipt to be issued, but also a final prospectus delivered to each subscriber. Final prospectuses can only be delivered after a final receipt has been obtained and tickets have been contracted. Traditionally, final prospectuses are only deemed to have been received after two business days have passed. This results in an artificial extension of the termination of the restricted period.

Short covering when a deal is fully sold should not be considered stabilization and hence prevent the removal of price and trading restrictions.

With respect to securities exchange take-over bids and amalgamations/arrangements, etc., we find the length of the "restricted period" as defined from date of announcement to the date of approval/deposit of securities to be unnecessarily broad. We recommend that the restriction should apply during the solicitation period, which is effectively the seven day period immediately before the scheduled shareholder vote. Full, true and plain disclosure is achieved when the shareholders receive the circulars with respect to the securities exchange take-over bid or amalgamation/arrangement and can then evaluate the personal and market impact.

- **Research activities**

The proposed rule to allow research compilations and industry research reports to be published under the prescribed conditions outlined should serve useful in certain circumstances. We would however make the following observations on the proposal.

1. If a current recommendation is to be presented we believe there should be the ability to both lower or raise the rating as we see fit in reaction to macro/industry or company related developments, share price movements etc… A constrained rating would be of limited use to investors in our view and could be misleading.

2. If a rating is to be presented for a security, we believe that the ability to comment on recent developments and events, which could affect the security, is required. The inability to publish company specific research comments could render the rating to be of limited use to investors.

3. The term "reasonable regularity" needs to be more clearly defined.

The form of allowable research needs to be described more clearly. For example, are comparable tables and industry reviews the primary forms of research acceptable under the proposal?

- **Exemptions**

  - Similar to the ETF exemption, there are other securities that trade relative to the NAV of an underlying basket of securities, for example fund of trust units, split shares, that should be afforded the same exemption.

- The definition of a basket trade is too restrictive, particularly for baskets where less than 20 securities are involved. We propose an exemption for baskets that substantially represent a recognized index and in which the offered security represents no more than 10% of the value of the basket. Given the proliferation of indices and index-related products, more flexibility is needed in this particular area.

- Interlisted arbitrage activity should be exempted.

- An exception from price and trading restrictions for Restricted Dealer proprietary trading for index adjustments should be granted when a Restricted Security is the subject of an index change.

- The definition of "offered security" is too broad and should be harmonized with the Proposed OSC rule and Reg M. BMO Nesbitt Burns does not agree with the proposal to deny an exemption for non-convertible preferred shares, non-convertible debt securities and asset-backed securities. These securities are traded on the basis of yield and credit rating. The criteria for restriction should not be whether the class of securities is illiquid and vulnerable to manipulation. The criteria for restriction should be whether manipulation of the securities can influence the market price of the offered security. We fail to see this connection for non-convertible preferred shares, non-convertible debt securities and asset-backed securities.

- **Short Sales**

The proposed rule contains an exemption permitting a dealer-restricted person to cover a short sale entered into prior to the dealer-restricted period. We also recommend that dealer-restricted persons be able to cover short sales entered into during the restricted period. Reg M prohibits the covering of short sales entered during certain periods of time if the purchase of offered securities is from an underwriter, broker or dealer participating in the offering. The Reg M prohibition would constitute an appropriate and sufficient restriction.
As well, as stated above, short covering should not be considered part of market stabilization activities.

- **Offered Security**

The proposed definition of "offered security" does not include a test as to the significance or materiality of a merger or acquisition to an acquirer/offeror and thus no consideration is given to whether or not it is appropriate for such securities to be designated as "offered securities" subject to the trading/research restrictions contained within the proposed amendments to the market stabilization rules.

- **Connected Security**

- The proposed definition of "connected security", section 2 (a), is incorrectly worded, and will not have the intended effect. We suggest that the definition of "connected security" be amended to read:
  (a) a listed security or quoted security which is immediately convertible, exchangeable or exercisable into the offered security unless the price at which the security is convertible, exchangeable or exercisable into the offered security is greater than 110% of the best ask price of the offered security at the commencement of the restricted period;

  This rewording would capture, for example, the purchase of deep in the money options that could be exercised immediately into the offered security, and hence influence the market price. The proposed definition would not capture this activity.

- The proposed definition of "connected security", section 2 (b), designates a "connected security" to be a listed security or quoted security of the issuer of the offered security or another issuer that, according to the terms of the offered security, may significantly determine the value of the offered security.

  This is a vague and ambiguous definition that will lead to difficulty in identifying securities that are subject to trading/research restrictions. What is the measure of "significant"? RS should define more specifically the situations that would result in section 2 (b) being invoked.

- **Significant Private Placements**

  RS has requested comment on whether it would be appropriate to restrict stabilization activities where the Participant is an agent in a "significant" private placement (for example, more than 5% of the issued and outstanding shares of the issuer).

  It is our opinion that private placements should be subject to the same treatment as special warrants. No special restrictions should apply, even in the case of "significant" private placements.

- **Significant Public Offerings**

  RS has requested comment on whether it would be appropriate to restrict stabilization activities where the Participant is an agent in a "significant" public offering (for example, more than 20% of the issued and outstanding shares of the issuer).

  It is our opinion that there should be no special rules associated with "significant" public offerings. The size of the issue is not the determining factor; the criteria for the determination of "highly liquid" securities will suffice to manage the process.

Regards,

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