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Chapter 4

Understanding How Investors Make Investment Decisions and Better Meeting the Needs of Investors

4.1 Clearly a paramount objective in any attempt to modernize securities legislation, or in any attempt to enhance the competitiveness of Canada's capital markets, is to address the needs of those who actually invest in those markets. This objective – as do several others, addressed elsewhere in this Report – permeated every aspect of the Task Force's deliberations.

4.2 Investors in the capital markets need to have confidence that they have a route to recovery when wrongly injured (civil liability), they need to have confidence that the capital markets are not "rigged" against them through informational asymmetries favouring large, "connected" investors and confidence that those who break the rules of the market or engage in unprincipled behaviour will be punished (hence the necessity for vigorous enforcement of securities laws). These issues are fundamental to a decision whether to risk money in the capital markets at all. Assuming that decision has been made, the next question every investor in the capital markets asks is, of course: "what should I buy?"

4.3 This chapter focuses on some of the issues central to the question, "what should I buy?"

- How do investors make investment decisions?
- Is the form of presentation of public company disclosure adequate for investors' needs, to enable sound investment decisions to be made?
- What opportunity does an investor have to take reasonable steps to be informed prior to investing?

4.4 Each of these questions has received our attention and will be addressed in this chapter, with our recommendations.

How do Investors Make Investment Decisions?

4.5 For the moment let us start at the beginning: how do investors make their investment decisions? Obviously this question does not evoke a single answer – every investor will have a unique approach to making investment decisions. Nonetheless, research commissioned by the Task Force[1] indicates that there are a number of general conclusions that can be drawn.

[1]See R. Deaves, C. Dine & W. Horton, "How are Investment Decisions Made?" in Volume II, D. Kingsford Smith, "Importing the E-World into Canadian Securities Regulation" in Volume V and J. Sarra, "Modernizing Disclosure in Canadian Securities Law: An Assessment of Recent Developments in Canada and Selected Jurisdictions" in Volume II.

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4.6 First and foremost, while the models used in the economics and finance literature generally paint the typical retail investor as someone with unlimited cerebral capacity who is able to consider all relevant information, filter out all that is irrelevant and measure the motives of all parties prior to making an investment decision, the typical retail investor, understandably, falls well short of this ideal.[2] Instead, the typical retail investor is limited by the standard foibles that are present in all of us to varying degrees – short attention span, inattention to detail, dependence on potentially suboptimal predispositions,[3] overconfidence, biases and emotion, to name a few.

"One problem with the philosophy behind disclosure is that information dissemination is often viewed as tantamount to information assimilation."

– Richard Deaves et al. "How are Investment Decisions Made?" in Volume II.

4.7 Much of the information that is required to be disclosed under securities laws is difficult to digest and, arguably, has the tendency to reinforce an investor's short-comings rather than helping to overcome them. One need only look at the form and content of a typical prospectus to see why this is the case. While research indicates that a surprisingly high percentage of investors consult an issuer's prospectus prior to making a decision to invest in the primary market,[4] the dense legal and technical language, the small print, the prevalence of jargon, the sheer length of the document, and the volume of information presented easily results in information overload. "When information overload occurs, there is a tendency for retail investors to simply tune out and not try to process the information at all."[5]

4.8 Against this back-drop the Task Force has focused on attempting to make recommendations to increase the *effectiveness* of disclosure. Regulators have generally focused on ensuring that disclosure reduced informational asymmetries and that there is an equality of access to information. This is but one component of disclosure. As Professor Kingsford Smith points out,[6] it is completely unrealistic to expect that the current forms of dense disclosure will protect from deception investors with low levels of financial literacy or prevent investors from being "snowed" and confused or turned off disclosure material by its massive volume and technicality.

[2]Deaves et al., *supra* note 1 at 252.

[3]*Ibid*. at 253 outlines some of the main heuristics that seem to matter in the context of investment decision-making: "diversification heuristic" (the tendency, when unsure what to choose, to choose a bit of everything); "ambiguity aversion" (where, for example, in experiments, people are more willing to bet that a ball drawn at random from an opaque jar is red or blue if they know that the jar contains 10 red and 10 blue balls, compared to a situation where they are simply aware that the bag contains red and blue balls but are unaware of the proportions); "status quo bias" (the heuristic that helps explain infrequent portfolio rebalancing – a person's preference for what they already own simply because they own it); "familiarity bias" (which is the comfort that people have in the familiar and is related to status quo bias); "representativeness" (one key element of which is recency, which exists when people judge the nature of the population by a recent sample of data, which has been used to explain why people chase winning stocks); and "anchoring" (which occurs when people pay insufficient attention to the arrival of new data – this is the opposite of recency).

[4]See Deaves et al., *supra* note 1 at 302 and Kingsford Smith, *supra* note 1 at 301 citing U.S. and Australian research.

[5]Deaves et al., *supra* note 1 at 263.

[6]Kingsford Smith, *supra* note 1 at 304.

> The longer we experience disclosure as a technique of financial regulation, the more we know about the limits on its effectiveness. That is not to suggest that it should not be relied upon – on the contrary, nothing convincing has appeared on the regulatory landscape to replace it, and the purposes of disclosure are still valid.[7]

The key is to make disclosure effective.

4.9 So, how does one make disclosure effective? Obviously, there is no perfect answer – effective disclosure to one person may not be at all effective to another. Gloria Stromberg has cited three components of effective disclosure: (i) identification of appropriate disclosure items; (ii) communicating the information in a way that facilitates the third component; which is, (iii) understanding what is disclosed.[8] Securities regulators have certainly issued a myriad of different rules dealing with the first item. However, the Task Force believes that the second component, the method by which information is communicated, is the key starting point in ensuring effective disclosure.

4.10 There has, of course, been a movement afoot (more so in other jurisdictions[9] than in Canada[10]) to mandate the use of "plain language" in disclosure documents. The Task Force certainly adds its encouragement to regulators in advancing the laudable goal of ensuring that disclosure documents are written in a form of language that is easily understood by investors. However, at the same time, the Task Force acknowledges the challenge of ensuring that "plain" disclosure is also "full" disclosure, as required under securities laws. Those drafting disclosure documents are without doubt acutely attuned to this challenge and the anecdotal evidence would suggest, not surprisingly, that there is a strong tendency to err on the side of ensuring "full" disclosure at the expense of "plain" disclosure. This pragmatic choice is in part premised on the recognition that many investors have available to them the expert advice of registered advisers to clarify disclosure that may be difficult to understand. Accordingly, the Task Force sees a danger in putting too much emphasis on the need for plain language and would prefer to direct regulatory focus at exploring ways to present information to investors more effectively. The use of plain language on its own will not make disclosure effective.

Recommendation: *The Task Force encourages securities regulators to work to make disclosure documents more effective by improving the method by which information is made available to investors to enhance the penetrability and comprehensibility of that information.*

[7] *Ibid*.

[8] As cited in Deaves, *supra* note 1 at 272.

[9] See for example, (i) the European Union *Prospectus Directive; Commission Regulation (EC)* No. 809/2004; and, (ii) the United States Securities and Exchange Commission, *Plain Language Disclosure Proposing Release*, Release No. 33-7380 and *Plain Language Disclosure Adopting Release*, Release No. 33-7497 (January 28, 1998).

[10] There is no over-arching plain language requirement in Canadian securities laws. Nonetheless, plain language policy statements have been incorporated into many of the primary disclosure instruments and rules. See for example, (i) s. 4.2 of the Companion Policy to National Instrument 44-101 – *Short Form Prospectus Distributions*; (ii) s. 1.2 of the Companion Policy to Ontario Securities Commission Rule 41-501 – *General Prospectus Requirements*; (iii) s. 2.2 of the Companion Policy to National Instrument 43-101 – *Standards of Disclosure for Mineral Projects*; and (iv) s. 1.5 of the Companion Policy to National Instrument 51-102 – *Continuous Disclosure Obligations*.

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Effective Document Delivery

4.11 Having concluded that effective disclosure requires an improvement in the method by which information is communicated to investors, the Task Force explored ways in which such improvements might be made. The Task Force's starting point was to consider the manner in which the various disclosure documents prescribed by securities laws are delivered to investors.

The Current Landscape

4.12 Before presenting our recommendations in the area of disclosure document delivery, a basic overview of the current rules may be helpful. Canadian securities laws often require that a disclosure document be "filed" and/or "delivered". The words "filed" and "delivered" are terms of art within securities law and there is a distinction between them. The filing of a disclosure document under Canadian securities laws will generally mean that it will be made available for public review and posted electronically on the internet accessible System for Electronic Document Analysis and Retrieval ("SEDAR"),[11] which was established by the Canadian Securities Administrators in 1997. In contrast, the term "deliver" is generally used in Canadian securities laws to describe the physical delivery of disclosure documents by a reporting issuer to its securityholders or prospective investors.[12]

(a) SEDAR

4.13 The creation of SEDAR was a significant move in streamlining the filing of disclosure documents by electronic means. SEDAR serves several functions. Electronic filings using SEDAR significantly reduce the time and effort required by issuers to file documents with securities regulators. Before SEDAR, filings were required to be made with each provincial securities regulator separately. SEDAR, as the central repository for filings with each of the Canadian securities regulators, allows issuers to make only one filing of each document. Similarly, SEDAR facilitates the electronic payment of required filing fees and allows for "one stop" payment.

4.14 Perhaps most importantly, filings made using SEDAR are posted under the reporting issuer's profile on the SEDAR website[13] thereby creating a free, publicly accessible full record of all of the disclosure documents required to be filed by a reporting issuer under Canadian securities laws.

4.15 SEDAR is not without its imperfections. Posting to the SEDAR website is not "real time" – there is usually a one day delay between the time a document is filed and when it is available to investors on SEDAR.[14] It has been noted that SEDAR appears to have been created with the filer rather than the investor in mind, making it difficult to find information (e.g. the search function is often regarded as cumbersome). Also, there are too many documents filed under the catch-all categories "Other", "Material Document" or "Security holders Documents", which often necessitates the needless opening and review of many documents.[15] Nonetheless, as

[11]See National Instrument 13-101 – *System for Electronic Document Analysis and Retrieval (SEDAR)*. SEDAR is operated by CDS Inc., a subsidiary of the Canadian Depository for Securities Limited, the central clearinghouse for securities in Canada.

[12]Case law, while not providing a clear definition of "delivered" or "delivery", does draw a distinction between "filing" requirements and "delivery" requirements. Specifically, "delivery" is referenced when documents are required to be provided to securityholders. See *Clarington Funds Inc. et. al., Re,* (2005) 28 O.S.C.B. 7335 and *Barrick Gold Corporation, Re*., 2003 ABSECCOM ORD - # 1163809.

[13]Unless such a filing is made on a confidential basis as is permitted in certain limited circumstances.

[14]"Real time" access to filings is available for a fee.

[15]See Kingsford Smith, *supra* note 1 at 325.

discussed below, SEDAR's role as a time-tested, electronically accessible and free repository of disclosure documents makes it the key ingredient in creating a more effective method of delivering information to investors.

Recommendation: *The Task Force recommends (i) that the search features of SEDAR be expanded to allow for more detailed searches of disclosure documents, and (ii) that the taxonomy for disclosure documents filed on SEDAR be further refined to reduce the dependence on the use of "catch-all" categories.*

(b) Electronic Delivery of Disclosure Documents Today

4.16 The development and utilization of SEDAR is illustrative of the adoption of technology to facilitate the electronic filing of documents with securities regulators and the creation of a free, publicly accessible internet location for such documents.

4.17 In contrast, the development of National Policy 11-201 - *Delivery of Documents by Electronic Means* ("NP 11-201") was but a timid step in the adoption of technology to facilitate the delivery of disclosure documents to securityholders.[16] It should be noted at the outset, however, that NP 11-201 is only a policy statement of the securities regulators and does not mandate the electronic delivery of disclosure documents to securityholders.[17] NP 11-201 merely provides policy guidance on the methods of electronic delivery that are viewed as permissible by the securities regulators.

4.18 NP 11-201 provides guidance on the use of electronic means to deliver disclosure documents such as prospectuses, financial statements, trade confirmations, account statements and proxy solicitation materials, all of which are required to be delivered to a reporting issuer's securityholders.[18] Unless such disclosure documents are delivered to securityholders electronically in compliance with NP 11-201, they are expected to be delivered in paper form.

4.19 NP 11-201 sets out the way in which the obligation imposed by provincial securities legislation to "deliver" disclosure documents can be satisfied by electronic means, but it does not extend to deliveries where the method of delivery is specifically mandated by securities legislation. In particular, NP 11-201 requires that a deliverer of a disclosure document by electronic means must provide evidence that the document has been delivered or otherwise made available to the recipient. Moreover, the deliverer must ensure that the recipient receives notice of the electronic delivery, has easy access to the document and, in fact, receives a document that is not different from that delivered by the deliverer. Under NP 11-201, a deliverer will generally satisfy the notice, evidence and access components of electronic delivery by obtaining the informed consent of an intended recipient to the electronic delivery of a document and then delivering the document in accordance with the consent.

[16]The United States Securities and Exchange Commission has adopted instruments of a similar nature. See, *Use of Electronic Media*, SEC Interpretive Release No.s 33-7856, 34-42728, IC-24426; File No. S7-11-00 (April 25, 2000), Securities Act Release No. 7233 (Oct. 6, 1995) [60 FR 53458] and Securities Act Release No. 7288 (May 9, 1996) [61 FR 24644].

[17]Policy statements are intended to provide public guidance to issuers and market professionals with respect to the regulators' interpretation and proposed application of securities laws and with respect to the facts and circumstances that would most likely trigger regulatory intervention. Unlike rules, policies are not required to be submitted to the minister of finance before they are finally adopted.

[18]Subsection 1.3(5) of NP 11-201 provides that: "This Policy does not apply to documents filed with or delivered by or to a securities regulatory authority or regulator."

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4.20 It is of note that, despite NP 11-201's potential to facilitate electronic delivery of disclosure documents, and at the same time reduce the burden of paper document delivery, the potential has been muted by the requirement that paper delivery be reverted to in many instances. Under NP 11-201 the securities regulators recommend that deliverers make a paper version of every document delivered by electronic means available at no cost to a recipient upon request of such recipient, regardless of the form in which the document was originally delivered. Moreover, with respect to the required form and content of electronic document, NP 11-201 requires the current paper version be recreated in electronic format (instead of simply being scanned into electronic format).

A Way Forward – "Access Equals Delivery"

4.21 Bearing in mind the strength of SEDAR as a free, publicly accessible full record of all of the disclosure documents required to be filed by a reporting issuer under Canadian securities laws, as well as the very tentative move towards permitting full electronic delivery of disclosure documents, the Task Force set about determining the most effective and modern method of delivery.

4.22 The starting point for the Task Force was, of course, the investor. Focusing on retail investors for the moment, it would seem that investors can largely be divided into (i) those who are (or believe they are) sufficiently financially literate (for the sake of convenience we call them Independent Retail Clients or "IRCs") and do not need, or choose not to make use of, a registered financial adviser, and (ii) those who use a registered financial adviser (the "Dependent Retail Clients" or "DRCs").

4.23 Then there is the question of "e-literacy" – i.e., the basic ability to use the internet. Intuitively, IRCs are in all probability e-literate users of the internet and, in all likelihood, the majority conduct their trading through internet brokerage accounts. Of course, some may not be e-literate, but it is hard to assume that this group is significant in size. With regard to DRCs, the percentage who are e-literate will logically be smaller, but nonetheless high – Statistics Canada reported in 2004 that 64% of households in Canada have at least one member who uses the internet, with 65% of regular users having a high-speed connection.[19]

4.24 One can certainly assume that all institutional investors access disclosure information electronically as a regular business practice.

4.25 Research commissioned by the Task Force indicates that retail investors are generally receptive to receiving disclosure information only in electronic form, with between 54% and 67% (depending on the type of information being disclosed) expressing comfort with receiving information *only* in electronic format.[20]

4.26 With these factors in mind, the Task Force questioned whether it continues to make sense to burden the disclosure system with the requirement of delivery by paper and, taking it one step further, whether the delivery of disclosure documents to investors, even by electronic means, makes sense.

[19]Statistics Canada, *Household Internet Use Survey*, July 8, 2004 as cited in Kingsford Smith, supra note 1 at 310.
[20]See Deaves et al., *supra* note 1 at 286.

The conclusion reached was that Canada should take the leap to an "access equals delivery" system of information delivery.[21]

4.27 What does "access equals delivery" mean? In popular parlance the term "access" is defined as "the right to use something" or "the retrieval of information stored in a computer's memory".[22] Within the realm of securities regulation, "access equals delivery" means, quite simply, that the regulatory requirement to deliver a disclosure document to an investor will be satisfied by the investor being able to access that document using the internet. For example, under an "access equals delivery" model, the posting of a disclosure document on SEDAR would satisfy both the filing and delivery requirements imposed by securities laws. As noted above, SEDAR's free accessibility and its function as a central repository of disclosure documents makes it the obvious foundation for the "access equals delivery" model.

"Existing requirements for cumbersome physical delivery of documents…can be expensive, wasteful and inefficient. Many of these documents, moreover, are not read and find their way very quickly into the recycling bins of the recipients…. In our view, securities regulators in Canada should go much further in either permitting electronic delivery of documents or, better yet, adopting the 'access equals delivery' concept…."

– Canadian Bankers Association (written submission to the Task Force in Volume VII).

4.28 The "access equals delivery" model gains additional credence when one considers the differences in information delivery between investors in the primary and secondary markets. While it is necessary to deliver a preliminary prospectus and (final) prospectus to an investor in the primary market before an investor makes an investment in securities, an investor who is considering making or disposing of an investment[23] in a security in the secondary market receives his information through his own intervention – accessing it himself. There is no requirement for an issuer to deliver to secondary market participants a copy of its annual information form, or copies of material change reports. Since secondary market trading represents something like 95% of aggregate trading in Canadian markets, it is time for a similar "access is adequate disclosure" regime to apply to documents designed for primary market transactions.

4.29 If we are to move to an "access equals delivery" model, whether with respect to primary market documents or secondary market documents, should those investors who prefer paper for whatever personal reasons have the right to demand that indulgence? Paper production is extremely expensive and no longer warranted in the "e-world". To permit a few investors to demand paper disclosure and thereby impose a cost on all shareholders of the issuer would largely thwart the cost savings of shifting to an "access equals delivery" model. If an investor insists on paper disclosure, it is our view that they can

[21]The Task Force is not the first to present this idea. Others, most notably the United States Securities Exchange Commission in the area of proxy materials, have put forth the concept of "access equals delivery". See, Securities and Exchange Commission, 17 CFR Parts 240, 249 and 274 (Release Nos. 34-52926; IC-27182; File No. S7-10-05) RIN 3235-AJ47. In addition, the *Five Year Review Committee Final Report - Reviewing the Securities Act (Ontario)* at 94 recommends that the Canadian Securities Administrators monitor the success of other access equals delivery models, such as the limited form of access equals delivery contemplated by National Instrument 51-102.

[22]Oxford English Dictionary at http://www.askoxford.com/concise_oed/access?view=uk

[23]After becoming a securityholder the investor will receive from the reporting issuer disclosure documents such as financial reports and associated MD&A, as well as information circulars and proxies as mandated by applicable securities law and corporate law requirements.

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download the document and print it themselves or, if their home facilities do not readily permit that, ask their adviser to print a copy. If the investor in question does not have an adviser, perhaps they will be motivated to retain one, which can hardly be regarded as a negative consequence.

4.30 The research which we have commissioned suggests that a significant issue in shifting to the "access equals delivery" model is to get the consent of investors to information being made available to them in electronic form. Much time is devoted by Professor Kingsford Smith to the issue of how such consent might be practicably obtained.[24] Our view is that this hurdle should be removed, not jumped. Consent should be implied in the decision to invest in a system where "access equals delivery" is the accepted medium of information dissemination.[25] There are potential ramifications for such a recommendation in the area of shareholder meetings, for example. Issuers must, of course, notify shareholders that a meeting has been called. This can be accomplished either by way of a post-card sized notice of availability of electronic proxy materials (as is contemplated in the United States – see Appendix D1) or by notice in the public media. The details of the manner by which effective notice may be given will require resolution. However, we do not believe that it is necessary for shareholders to have a right to paper meeting materials if they are available electronically.

Recommendations: *The Task Force recommends: (i) that all requirements for the delivery of disclosure documents be abolished and, instead, that all disclosure documents be required to be filed on SEDAR and on the issuer's website, and (ii) the elimination of any requirement to "deliver" a document would render investor consent to "access equals delivery" unnecessary.*

More Effective Disclosure Documents – The "Democratization of Information"

4.31 As the "access equals delivery" model is premised on investors electronically accessing disclosure documents on SEDAR or on the issuer's website, the constraints of paper disclosure – its static presentation of data and its two-dimensional nature – can be overcome with fully electronic disclosure that can take full advantage of the latest advances in technology. The goal, of course, is to make disclosure more effective, by making it more appealing, less intimidating and more understandable.

4.32 How can this be done? One idea that has met with a great deal of enthusiasm has been the United States Securities Exchange Commission's voluntary program for reporting financial information using Extensible Business Reporting Language ("XBRL"). XBRL allows for the "tagging" of data items in a disclosure document, i.e., information is embedded in the text of a document which allows it to be identified by the computer – for example, the general and administrative expense line in a balance sheet would have its own unique tag. The tagging is done according to agreed taxonomies to allow items in the disclosure to be identified in the same way. When this is done computers can recognize particular items of data, such as the general and administrative expense line in a balance sheet, analyze it, store it, exchange it with other computers, compare it, all in a manner that is chosen by the particular user.[26] In other words, the data come "alive" for the user.

[24]See Kingsford Smith, *supra* note 1 at pages 313 to 316.

[25]This will, in turn, necessitate the elimination of the two-day statutory right of rescission given to investors who purchase securities pursuant to a prospectus.

[26]In this and the next paragraph we rely heavily on the description and terms used by Kingsford Smith, *supra* note 1 at 333.

4.33 A move to fully electronic disclosure will also facilitate the "layering" of information within a disclosure document. As we have noted, the common problems with existing forms of disclosure are volume and density. "Layered" electronic disclosure would, in layer one, present a basic summary of the information to be communicated to the investor. The reader would then have the option to "click" on a piece of information that is of particular interest and enter additional "layers", each with an increased level of detail. An additional advantage of electronic "layering" will be the ability to "pull" information from existing data sources. For example, an Annual Information Form filed pursuant to a reporting issuer's continuous disclosure obligations could "pull" the issuer's financial results from its annual and quarterly financial statements. (More will be said about the information layering concept in Chapter 5 when we outline our recommendations to permit faster access to the capital markets by issuers).

4.34 Fully electronic disclosure would also permit an investor to interact with the information being presented. An analogy that the Task Force has used is to compare the review of disclosure relating to a reporting issuer prior to making an investment decision with the review of information relating to any other on-line purchase. For example, when deciding whether to book a room at a particular hotel, a consumer in the internet age is likely to visit the hotel's website to take an on-line tour of the hotel's suites. So, prior to making a decision whether to purchase the trust units of a real estate investment trust or the shares of a mining company, why shouldn't an investor be able to access the issuer's on-line disclosure and tour its properties or mines? To do so would make the investor's experience immensely more interesting than pure narrative and might well encourage reading the accompanying narrative for essential factual input.

4.35 Computer and internet experts consulted by the Task Force regarding the recommendations in this section have indicated that the technology necessary to implement them is readily available. Indeed, we have included along with this Report a CD-ROM showing design examples of annual information forms utilizing XBRL, information layering and interactivity. We have named our design "MERIT" - Model for Effective Regulatory Information Transfer. A separate presentation of a technical white paper for MERIT will be found in Schedule 4 – A to this Chapter.

Recommendation: *The Task Force recommends that MERIT (Model for Effective Regulatory Information Transfer) be thoroughly considered and that securities regulators encourage and facilitate the use of XBRL, information layering and interactivity within electronic disclosure documents, all as detailed in the technical white paper included in Schedule 4 – A to this Chapter.*

4.36 Much has been said about the impenetrability and sheer bulk of current disclosure documents (taking prospectuses and Annual Information Forms as exemplary, if this is not too perverse a way to put it). Policymakers have long searched for the right solution, going back to the days – within the memory of some on this Task Force – when prospectuses could not include a summary for fear that only the summary would be read and that it would not fairly balance the "promise" and the risk of the investment. We have come a long way, but with creativity we can go further.

4.37 Our earlier recommendations in this Chapter regarding the use of MERIT and XBRL are important suggestions to address the issue of dense disclosure. That will take time and there is a more immediate prescription – using paper-based disclosure – which appeals to us in the interim.

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4.38 In the case of offering documentation, for example, some have recommended an expanded summary document for delivery to investors. For example, in its submission to us, the Investment Dealers Association of Canada proposed that "in addition to the prospectus, issuers be required to provide a summary document containing issuer information relevant to the investor." Such a summary "(a) would convey in plain language the essence of the offering, without all the technical details currently contained in the prospectus; (b) would not attract liability to issuers…; and would be no more than 2 pages in length".[27]

4.39 Research commissioned by us specifically addresses this issue. Professor Kingsford Smith suggests the use of a very short "foundational document" that sets out the basic information about the security on offer and the issuer in concise and simple terms. A second short document containing issuer and investment specific information would also be produced. Such a document would contain information about the issuer, its business, its plans and prospects, its management and, consequently, the prospects for investment in the securities being distributed. It would describe the riskiness of the investment in a fashion that elaborates on the basic information in the "foundational document".[28] Finally, the complete prospectus or Annual Information Form would be produced.

4.40 We endorse this recommendation as an interim measure and believe that providing paper-based disclosure using layers of gradually increasing depth and complexity will serve the interests of investors who may determine the depth of disclosure which is informative for them.

4.41 Layered disclosure will naturally raise issues of liability since the primary and secondary levels of disclosure would by necessity not be full but only true and plain. This reality would be addressed by appropriate cautionary language that full disclosure of all material facts can only be obtained by access to the full disclosure document. Moreover, liability for a misrepresentation would attach to all layers taken together.

Recommendation: *The Task Force recommends that insiders of an issuer be obliged to give at least two business days advance notice of their intention to sell some or all of their securities in the issuer.*

Insider Trading

4.42 In Canada, holders of a "control block" of securities of an issuer (i.e., those with a sufficient number of securities to affect materially the control of the issuer) are restricted from selling their securities without a prospectus unless they first notify the market of their intention to do so. This clearly affords the market the time to adjust to the news that the control block holder is reducing its position.

4.43 No such pre-notification is necessary with respect to sales by an insider of an issuer who is not otherwise a control block holder. Insiders are required to notify the market only *after* they have sold securities. We find no logic to the different treatment of control block holders and insiders – the decision to reduce holdings is likely equally informative in respect of both groups.

4.44 The current practice in Canada varies, but we believe that the general "rule of thumb" used by many issuers is that an insider should not trade until at least the close of business on the second business day after

[27]Submission of the Investment Dealers Association of Canada in Volume VII.
[28]See Kingsford Smith *supra*, *note* 1 at 344.

material information has been publicly disclosed. The clear presumption behind this practice is that it takes two business days for the market to absorb new material information efficiently. In keeping with this practice we believe that it would be sufficient time for the market to arrive at whatever conclusion it wishes, if insiders were obliged to give a least two business days *advance* notice of their intention to sell some or all of their securities. Just as, in the case of a control block holder's notice of intention to sell becomes stale after a period of time if no trade has occurred, there will need to be a similar period when an insider's ntoce of intention to sell goes stale. We leave such details to those who may decide to implement this recommendation.

4.45 We are concerned that if a notice of intention to sell were to be given during an issuer's black-out period it might confuse the market as to the pending material disclosure. Is the prospective sale driven by "bad" results or by "good" results which will increase prices and generate selling opportunity? As a result, to avoid confusion, no notice of intention to sell should be given durng a black-out period unless the material information which gives rise to the black-out period has been publicly disclosed. This would permit the market to absorb the disclosure of information and the disclosure of intention to sell before a trade occurs.

4.46 We see no need for pre-notification of purchases of securities by insiders, since that information is not nearly as critical and we believe that the current rules applicable in such a situation, which preclude purchases from being made with the benefit of undisclosed material information, are sufficient protection.

Recommendation: *The Task Force recommends that, until MERIT and the use of XBRL can be implemented, paper-based disclosure be presented in layered format with each layer being of increasing depth and complexity thereby allowing investors to determine the depth of disclosure which is informative for them.*

Investor Education

4.47 While effective disclosure is an important component in making sure investors are as fully informed as possible prior to making an investment decision, disclosure alone cannot achieve this goal. The other important component is ensuring that investors have at least a basic level of financial literacy. An increasing number of Canadians are now responsible for managing their own retirement accounts. The shift from defined benefit pension plans with a guaranteed monthly benefit paid each month after retirement, to defined contribution plans, where investment risks and rewards are the responsibility of each individual, places increasing importance on improving

"Some key challenges [in the Canadian investor education landscape are]: a lack of national leadership, a lack of sustainable funding, a lack of coordination and communication among providers, a dearth of research, a lack of overarching effectiveness measures…and poor marketing and distribution…."

– Caroline Cakebread

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financial literacy.[29] As Caroline Cakebread points out in her study of investor education initiatives for the Task Force,

> the idea of proactively 'educating' investors rather than providing them with 'information' has grown in tandem with a shift in the role of the individual in planning for and ensuring there own financial well-being.... In addition, the growing number and complexity of financial products and investment vehicles adds another layer of urgency onto the need for 'education' to help individuals choose wisely.[30]

4.48 Since it is a reasonable assumption that a person's willingness to invest increases as they become more comfortable in the investment arena, and since that comfort will be enhanced by financial literacy, there is an external benefit to that literacy. *Increasing levels of financial literacy also functions to enhance the competitiveness of Canada's capital markets by increasing liquidity*. It has been noted that "better-informed investors would increase active participation in the market, thereby reducing risks and increasing market capitalization. More knowledgeable investors are also less susceptible and vulnerable to fraud and other market risks."[31]

4.49 Unfortunately, however, the literature and anecdotal evidence reviewed by the Task Force indicate that the general level of financial literacy in Canada is low. For example, a recent report published by the Government of Canada stated that a national investment literacy test found that a staggering two-thirds of Canadians are "functionally illiterate when it comes to investment knowledge."[32] The same report also stated that "42 percent of Canadians do not have the basic literacy and life skills to cope with the demands of our knowledge society and economy."[33]

In the era of defined contribution pension plans, addressing this situation is a national imperative.

4.50 Research conducted by Sun Life Financial Inc. on the attitudes of defined contribution plan sponsors concerning their members showed the effect of poor investor education. Some 43% of sponsors rated their members' confidence about managing their retirement as "poor", 33% of sponsors stated that greater than 60% of their members were still fully invested in low risk, low return, "default" plans that will not provide adequate funds for retirement.[34]

4.51 There is an obvious failure in Canada to educate investors. How can this be explained? It is apparent to us that there are plenty of extremely well-designed information sources from which investors can obtain the basics to lead to financial literacy. The internet in particular is full of excellent private sector and public sector investor education sites. In Canada, a number of the members of the Canadian Securities Administrators maintain free investor education websites and "appear to be leaders in providing investor

[29]See Government of Canada, *Why Financial Capability Matters – Synthesis Report on Canadians and Their Money: A National Symposium on Financial Capability held on June 9-10, 2005* in Ottawa, at 7.
[30]C. Cakebread, "Investor Education in Canada: Toward a Better Framework" in Volume III at 357.
[31]*Ibid*.
[32]*Ibid*.
[33]Government of Canada, *supra* note 8.
[34]As cited in Cakebread, *supra* note 30 at 357.

education in Canada today".[35] Caroline Cakebread notes some of the strengths of the investor education initiatives undertaken by members of the Canadian Securities Administrators:[36]

> 1. *Ability to develop and distribute investor education resources in schools* – for example, British Columbia is a leader in this area, particularly as the materials are a mandatory part of the curriculum in British Columbia. Ontario, through the Investor Education Fund, has also developed extensive teacher resources and has developed an innovative approach to training high school and elementary school teachers to deliver financial education to their students.
>
> 2. *The development of Web-based information for consumers* – there is extensive information available to educate and inform investors on the Web sites of securities commissions (glossaries, articles, investor alerts etc). In addition, the commissions are beginning to link to one another's sites and to leverage nationally focused resources from the [Canadian Securities Administrators].
>
> 3. *The ability to target special needs groups* – Securities Commissions appear to be taking a leading role in providing investment information, resources and education to special needs groups within their jurisdictions (i.e., seniors, [specific ethnic groups], religious groups, and youth).
>
> 4. *Working towards collaboration* – Securities Commissions are also making significant strides in terms of furthering collaboration and working to harmonize efforts and eliminate future duplication. Currently, Investor Education Committee of the Joint Forum of Financial Market Regulators is undertaking research into the efforts of individual securities commissions to determine areas where harmonization can occur and where there is duplication. This research will be presented later in fall 2006.

4.52 The profusion of such education efforts, while in one sense laudable, is a glaring symptom of the disease prevalent in Canadian securities regulation generally – fragmentation and duplication of expenses. Caroline Cakebread notes that "there is no federal commitment to promote investor education and – on a greater level – financial education in Canada. Without a national mandate, it will be difficult to create sustainable programs with adequate funding to carry out the education function effectively and on a broad level."[37]

4.53 It is impossible to attach any credibility to the proposition that residents of different provinces need to have their financial literacy requirements addressed by a multiplicity of educational sources. Surely the financial resources which are realistically allocable to education can be concentrated and more productively coordinated. In our view, a crucial component lacking in the current investor education initiatives in Canada is national co-ordination in the design and availability of investor education resources.

[35] *Ibid*. at 370.
[36] *Ibid*.
[37] *Ibid*. at 371.

4.54 Accordingly, the Task Force recommends the creation of a national or pan-provincial coordinator of public and private sector investor education initiatives, whether through the Canadian Securities Administrators or another organization. Such a national coordinator might, for example, be responsible for minimizing duplication and maximizing the educational "bang for the buck" and working with ministries of education and school boards to ensure that basic financial literacy is achieved at the primary and high school levels. Importantly, the coordinator might also facilitate investor education programmes at the workplace and ensure that the sources of investor education materials, such as public sector websites, are well publicized.

4.55 The ever-increasing importance of investor education should not be underestimated. Indeed, we regard ensuring that every Canadian is financially literate as a national imperative. Accordingly, we recommend that stakeholders in the Canada's capital markets undertake a comprehensive study to design programmes that ensure that this imperative is achieved.

Recommendation: *The Task Force recommends that financial literacy be treated as a matter of national priority.*

Recommendation: *The Task Force recommends the creation of a national coordinator of public and private sector investor education initiatives.*

Recommendation: *The Task Force recommends that further study be undertaken by capital markets stakeholders to design programmes that ensure that the objective of financial literacy as a national priority is achieved.*

4.56 This Chapter has dealt principally with the critical need for investor education and the development of an acceptable level of financial literacy in Canada. However, we would be remiss not to mention that the competitiveness of Canada's capital markets also depends on: (i) the need to enhance the education of registered representatives (investment advisers) with regard to specialized products; (ii) the need to develop programs at the law schools to train future prosecutors and defence lawyers so that capital markets enforcement and litigation becomes a sought after career path; (iii) the need to offer specialized courses to police forces to prepare them for the intricacies of securities related offences, and lastly (iv) the need to develop a judiciary (whether in a special court or in the existing structure) skilled in, and familiar with, the issues which arise in capital market related cases. Each of these issues is of fundamental importance to the improvement of the capital markets in Canada. The education of the securities law enforcement apparatus is dealt with in our recommendations in Chapter 7.