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Research Study

Modernizing Disclosure in Canadian Securities Law: An Assessment of Recent Developments in Canada and Selected Jurisdictions

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Evolving Investor Protection

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1. Executive Summary

Disclosure is both a public policy objective and a public policy instrument in current Canadian securities regulation. As a public policy objective, full, true and plain disclosure advances the objectives of the legislation, specifically, the protection of investors, the promotion of efficient capital markets and public confidence in capital markets. As a policy instrument, disclosure reduces transaction costs, measures compliance and signals the quality of corporate governance of the issuer.

Canada's securities regime is unique in the world in that there are thirteen regulators in a country that has a relatively small share of the global capital market, and uneven regulatory approaches have created market inefficiency. Domestically, there are signs of convergence in some areas of securities law, through the establishment of national instruments and policies, the implementation of the Mutual Reliance Review System, and the recent passport system. Convergence in domestic disclosure requirements will reduce the cost to raise capital, enhance efficiency of Canadian capital markets and thus meet the public policy objectives of the Canadian disclosure regime.

A critical challenge in thinking about the modernization of securities legislation is how to truly make information accessible to all investors, while ensuring that issuers disclose the level of detail and depth that allows analysts to make informed decisions. This question implicates three principal parties to the disclosure, the issuer, the investor and the other market participants who have their own obligations to responsibly digest, filter and provide opinions on disclosure.

There are multiple challenges to modernizing disclosure in the Canadian system. Issuers, intermediaries and other market participants want certainty and cost effectiveness in disclosure requirements. The first issue is timeliness of disclosure and fragmentation of information across multiple documents. The second is that materiality continues to be problematic in terms of definitions under material change and material fact reporting, and it may be timely to redefine materiality to create a uniform standard, aligning national instruments, statutory and TSX listing requirements. Deference to business judgments regarding materiality needs to be balanced with the need for statutory compliance. The third difficulty is the lack of integration between the primary and secondary markets in terms of disclosure requirements, and consequent issues of clarity and accessibility. The current system means that investors need time, resources and tenacity to access all the information they require to make informed investment decisions.

With the increased involvement of retail investors in the market, both directly through on-line facilities and through managed investment funds, the nature of investor interests lies more along a continuum of interest, information and sophistication, rather than a two-tier dichotomy between retail and institutional investors. Institutional investors also run along that continuum in that while they are sophisticated investors, they have different interests, time horizons and priorities in their market activity. Modernization of the disclosure regime must recognize the diversity and complexity of investor interests along this continuum. Modernization of securities disclosure requires a regulatory approach that will give real meaning to the words full, true and plain disclosure. Such a move can enhance the role of intermediaries in creating informational access to investors who would not otherwise have the time, resources or capacity to make informed investment decisions. As policy choices are made in respect of modernizing disclosure requirements, they should be guided by focusing on how the particular rule will promote a culture of compliance and advance the policy objectives of the securities law regime.

2. <u>Summary of Policy Options and Recommendations</u>

The report proposes a number of policy options for disclosure, most notably:

<u>Option #1:</u> Maintain the status quo

One possible option is to maintain the *status quo* for a period in order for the market to gain some experience with current harmonization efforts under national instruments, e.g. NI 51-102 *Continuous Disclosure* and NI 44-101 *Short-Form Prospectus Distributions*, and recently announced changes to MI 52-111 *Reporting on Internal Control over Financial Reporting.* One problem for increased codification is that it may actually result in barriers for retail investors, where the disclosure is inaccessible in terms of the complexity of documents and fragmentation of information.

<u>Option #2:</u> Develop an effective electronic disclosure regime

Another option is to maintain the current disclosure framework, and concentrate on mechanisms to make disclosures more accessible and meaningful for investors, through devising a framework for web-based delivery and locating disclosures in one place on a "one-click full access" basis.

Securities regulators should consider how to move disclosure into a system that takes full advantage of technology. It is timely to consider whether an "access equals delivery" model should be implemented, and how the system could be fashioned to ensure that investors are fully informed based on materiality requirements, in as fully, accessibly and timely a manner as possible. The current fragmentation of electronic disclosure is a barrier to accessible disclosure and there is a need to centralize information. Hyper-links, which can enhance disclosure, can also create particular risks that need to be addressed in any move to a fully electronic system. The new U.S. "eXtensible Business Reporting Language" (XBRL) electronic platform should be considered as a possible disclosure enhancing tool for the Canadian capital market. Designing a workable and accessible e-delivery system is an appropriate policy priority in the next period.

<u>Option #3:</u> Develop an integrated market disclosure document (IMDD) and electronic disclosure system

A third option for a modernized securities system is to locate disclosure in one "living" electronic integrated market disclosure document (IMDD) that investors can access at any point in the life cycle of the issuer, whether it is making an offer of securities to the market or meeting its continuous disclosure obligations. This could include a summary as Part A of the IMDD that provides investors, in 4-5 pages, with a substantive and informative summary of material information regarding the issuer that conveys in a brief manner and in non-technical language the essential characteristics and risks associated with the issuer and the securities. Part A could caution that investors are to make any investment decisions based on the IMDD as a whole, and that no civil liability will attach to any person solely on the basis of the summary, unless it is misleading, inaccurate or inconsistent when read together with other parts of the IMDD.

Part B of the proposed IMDD would contain the financial statements and information that is currently disclosed in the AIF, providing the extensive and substantive financial and operational disclosure. Part B would provide a level of detail that would allow analysts and other market participants the full breadth of information required to make an informed assessment of the issuer, and provide an integrated snapshot of the issuer's capital, business and operations. Part C of the IMDD would contain MD&A type descriptions by senior officers, but would be directly referenced to Part B and hence eliminate duplicative information, with a specified standard on which to measure the quality of disclosure. It may also be timely to require disclosure in Part C in respect of corporate social and environmental responsibility measures, as part of the corporate governance disclosures, in order to align Canada with a number of other jurisdictions. This corporate responsibility reporting could be a general disclosure obligation or could be pegged to international standards such as the Global Compact, on a "comply-or-explain" basis. Part D of the IMDD would comprise Future Oriented Financial Information (FOFI), optional, as it is under the current regime, but with clear standards, based on either a reasonableness standard or reasonable investigation standard.

Subsequent material change reporting would then be integrated directly into the IMDD as one document, flagging the date of the change in disclosure. Press releases and the revised IMDD with the material change incorporated would clearly signal to market participants at the front of the document the nature of the change and location in the document. The IMDD as a whole would be the living disclosure document, and would include electronic "tags" specifying when the particular material change or information disclosure was integrated into the document.

This notion of a dynamic, current and accessible document is possible given technological developments. Instead of investors having to access numerous documents, plus trying to ascertain whether there have been material change reports, all information publicly available to the market would be contained in one document at all times, including a "last updated" reference. This model would place the emphasis on disclosure to meet the principal goals of informing and protecting investors, while generating efficiencies in capital markets. The transaction costs of converting to a single document would eventually be offset by the streamlined nature of the disclosure.

The proposed IMDD would eliminate duplication in primary and secondary market disclosures and would provide all market participants with single portal access to current material information about the issuer. It could be designed with the TSX and other exchanges so that issuers are required to meet only one set of disclosure standards, whether the activity is in the primary or secondary market.

There are also a number of other recommendations throughout the Report that the Task Force could consider in modernizing disclosure. A few of those key recommendations are included here in the summary:

Recommendation #1: Ensuring full, plain and true disclosure

Whatever policy option is adopted, disclosure documents should clearly identify their purpose and provide full, true and plain information in an accessible form. Full disclosure requires a level of completeness and sufficiency in quantity and degree where that information is material, such that investors can make informed decisions. True denotes a level of correctness and honesty. Plain includes clear, simple and readily understood. While plain language may be necessary for unsophisticated retail investors or those investors without the time or resources to analyze all disclosure documents, disclosure requirements must nevertheless continue to provide analysts, institutional investors, regulators and other market participants with the level of detail that they require to make informed judgments about their investment advice or regulatory approval. There is also the need for plain language in regulatory requirements, so that issuers of all sizes can understand and meet their disclosure requirements.

<u>Recommendation #2:</u> The role of underwriting in an IMDD regime

There is a public policy decision to be made in respect of whether there should be a continued gatekeeping role for underwriters in a modernized disclosure regime. There could be a requirement that a new IMDD that is available to the investing public for the first time would be accompanied by an underwriting assurance/certification regarding the IMDD. One option would be to enshrine a reasonableness standard in the statute, specifying that the underwriter "must be assured, before offering or recommending the securities, that the IMDD contains information that, to the best of the underwriter's knowledge and belief, is necessary for the investor, as a reasonable person acting reasonably, to make an informed investment decision" and then have a reference to the statutory provision containing this disclosure standard as part of the standard format of the IMDD. While the reasonableness standard would still have to be interpreted by the courts in order to provide some certainty to parties in their level of disclosure responsibility, it would shift the disclosure system to an investor-based, as opposed to a market impact-based standard, aligning securities regulation with the standard currently applied by the TSX to 85% of capital market activity in Canada, as well as standards in numerous other jurisdictions. Any move away from the use of underwriting must take account of the gatekeeping function that has been performed in disclosure assurances and provide for similar safeguards in any replacement regulatory disclosure regime.

Even if one were not to require underwriting assurances or certificates, there is likely to be a continued market for underwriters in securities offerings. Presumably, the role of the underwriter would continue where there is a bought-deal arrangement, as the underwriter would be representing its confidence in the disclosures by the nature of its arrangement with the issuer. There is also likely to be a market for underwriters where the issuer is relatively unknown to the market, or where the nature of the securities offered are novel or not well known, and hence the use of underwriter's assurances boosts the issuer's ability to sell the securities in a primary offering. If the underwriting process is eliminating, consideration should be given to bolstering the due diligence disclosure responsibilities of analysts and other intermediaries.

<u>Recommendation #3:</u> Integrity of electronic information and use of hyper-links

The regulatory framework for electronic and web-based disclosure should ensure the integrity of disclosure, in terms of measures that protect against information tampering. Regulation of a primarily electronic-based disclosure regime must make clear any rules with respect to issuer accountability or liability for hyper-links and other electronic and web-based links. Regulators must also be able to efficiently monitor electronic disclosure, particularly, tracking the timing of electronic disclosure. Attention should also be paid to how securities holders can establish delivery or non-delivery of information or access to information. If there is a move away from paper-based disclosure to fully electronic and web-based disclosure, the system design will need to ensure timely and cost-effective access to point-in-time disclosure or there will be high transaction costs associated with litigating access to that point-in-time disclosure. Canadian regulators should also ensure that electronic posting of regulatory requirements are consolidated and centrally located.

Recommendation #4: Materiality disclosure requirements

Materiality disclosure requirements of regulators and stock exchanges should be aligned to create one uniform standard. There should be serious consideration of moving to the TSX "material information" standard. It is also timely to reconsider moving from the current market-impact test to a reasonable investor test of materiality, to better align Canada with the U.S. and numerous other jurisdictions. However, such consideration needs to take account of new civil liability provisions for secondary market disclosure in ensuring that issuers know, with some certainty, the standards to be met.

Recommendation #5: Statutory guidance on deference to business judgment in disclosure

The objective of the disclosure requirement is to ensure that the issuer deals with disclosure of good news and bad news with equal urgency. Decisions on materiality require business judgments. If deference by the court to business judgments is too high, it will create incentives for issuers not to disclose. Deference to business judgment should apply only to judgments that are made on a reasonable basis after a duly diligent process. Given current information asymmetries, it may be necessary to place an onus on the issuer's officers to establish their due diligence, as has occurred in the context of takeover bid cases. Any deference given as a judicial interpretation tool or device should be carefully limited so as not to detract from both the express disclosure requirements in securities law and the goals of investor protection, market efficiency and public confidence in capital markets.

Recommendation #6: Linking change in disclosure requirements to policy objectives

Any recommendations developed for disclosure requirements should respond to the question of how the particular rule will promote a culture of compliance. Consideration should be given to the BCSC's approach of testing rules for their neutrality, scope, clarity and ability to assess effectiveness as any reform initiatives move forward.

<u>Recommendation #7:</u> Education as a companion policy instrument to disclosure

There must be enhanced investor education regarding disclosure and its benefits, risks and limits. Investors need to be alerted to the risks associated with various kinds of securities, as well as the benefits and limits of web-based disclosure. Enhanced investor education can provide investors with a greater appreciation of their own limits of time, resources and information to making investment decisions without the assistance of knowledgeable advisors. For analysts and other intermediaries, improved educational training can enhance their capacity to provide advice to clients and ensure a higher level of consistency regarding their dissemination of information. There should also be enhanced education of issuers so that they can meet their continuous disclosure obligations, including broader dissemination of best practice examples. Regulator could undertake this enhanced education, or alternatively, considerably more resources could be directed to educational institutions to provide cost-effective and accessible investor education.

<u>Recommendation #8:</u>

There is a need for increased research funding for empirical research in the area of disclosure and compliance, in order to better inform policy choices in the future.

Other jurisdictions are in early stages of similar disclosure initiatives. While the policy instruments vary, the goals of the various disclosure regimes are almost identical. None of the jurisdictions of those studied have implemented an integrated disclosure system yet. There are features, however, that should be considered as Canada moves toward modernization of its disclosure regime, including: mandatory summary sheets on disclosure documents; market integrity issues in respect of electronic disclosure; the relative benefits and risk of market impact versus reasonable investor tests for material disclosure; and early moves towards more integrated primary and secondary market disclosure.

3. **Introduction**

This report undertakes a consideration of disclosure in Canada and a comparative analysis of key issues in disclosure with five other jurisdictions, in order to discern whether and how disclosure requirements under Canadian securities law should be modernized. Disclosure as a subject of policy consideration is critically important, given the central role it plays in the regulatory scheme. It is also unwieldy as a topic for study, as disclosure implicates most other aspects of the securities law regime.

Part 4 of this report commences with a discussion of disclosure as a policy objective and a policy instrument in Canadian securities law. This return to first principles assists in shaping the discussion that follows. Disclosure has one principal purpose: the advancement of the statutory objectives of protection of investors, capital market efficiency and enhanced public confidence in markets. However, disclosure is also an important policy instrument in three respects: as a transaction cost control device, a regulatory tool and governance signalling device.

Part 5 examines requirements for full, true and plain disclosure and implications for both primary and secondary markets. Specifically, it explores whether current regulatory requirements create sufficient incentive to engage in full, plain and true disclosure and whether one should consider options to make disclosure more accessible to a broader range of investors. The report sets the discussion within the existing securities law framework, analyzing the dynamic tensions currently faced by regulators and market participants. British Columbia's proposed continuous market access model is examined as an alternative approach to disclosure.[1] This part also examines technological developments as a critical aspect of an enhanced disclosure regime, and considers the benefits and risks of moving towards an "access equals delivery" electronic disclosure model. Finally, this part considers the definition of materiality and possible reform options.

Part 6 examines the current regulatory framework for primary market disclosure in Canada, including the efficacy of current rules and instruments for primary market disclosure. This part also examines incentives for ethical behaviour by market participants and the interplay between business judgment and disclosure obligations.

[1] The B.C legislation will not be proclaimed in force at least before December of 2007; British Columbia Securities Commission News Release 10 February 2006, *Securities Laws to be Harmonized across Canada;* http://www.bcsc.bc.ca/release.asp?id=2944.

Part 7 examines secondary market disclosure in Canada and assesses whether the current system provides sufficient disclosure of material information to investors or constitutes overreach in terms of the requirements placed on issuers. It examines disclosure as a signalling device and a regulatory tool. It prospectively analyzes the implications of introducing into the Canadian framework a statutory civil remedy for continuous disclosure violations through amendments to the Ontario *Securities Act*.[2] It also considers the unification of primary and secondary market disclosure documents as a means to create more full, true and plain disclosure and to bring consistency in disclosure standards.

There are three principal issues in respect of disclosure. First is timeliness of disclosure. In some circumstances, delays in disclosure can prejudice investors and create inefficiencies in the market. One question is whether the system needs to increase the timeliness of disclosure, and if so, how. The second issue is the appropriate scope of required disclosure; specifically, whether material change and material fact are too narrowly defined, such that important information is not being disclosed to the market. Juxtaposed against this view is that there are higher transaction costs for the issuer associated with a broader definition of material information disclosure and a question of whether increased disclosure would fill the market with transient or ephemeral information. A third key issue is access to the disclosures made, in terms of accessibility, clarity and comprehensibility.

Considerable advances have been made by securities regulators in enhancing the disclosure system in recent years. Aside from the current normative debate about the degree of codification required, as discussed in Part 5, there is general consensus that full, true and plain disclosure of facts that are likely to affect the value or price of securities is an important standard as a baseline objective of disclosure. This point of convergence is the point to build on in thinking about further modernization of disclosure under securities law. The ideas generated within Canada and internationally can contribute to a more global understanding of the role, purpose and efficiency of disclosure.

A further question is how to weigh the risk that regulatory intervention may hinder market resolution to the problem and how one can measure the impact of particular rule changes. The system should allow capital to be raised at a reasonable cost while enhancing investor protection, and should allow regulators to focus on the quality of information in the market.

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[2] Part XXIII.1 *Ontario Securities Act*, effective December 1, 2005. A different model of civil liability is proposed under B.C's new securities legislation.

Part 8 of the report undertakes a comparative analysis of primary and secondary market disclosure requirements in other jurisdictions, surveying various recent approaches by securities regulators. It describes some of the key disclosure features and current developments of the systems, assessing the stated benefits and concerns surrounding the different approaches to curbing information asymmetries. As with Canadian securities law, regulation in the studied jurisdictions is based on a disclosure paradigm as opposed to a merit-based system. Disclosure features of five jurisdictions are examined, including the European Union (EU), the United States (U.S.), Australia, Japan and China. As a subset of the EU on some issues, disclosure developments in the United Kingdom (U.K.) are considered.

The report does not measure efficiency in systems, that task is left to another investigative report for this Task Force.[3]

In keeping with the objective of full and plain disclosure, the goal was to write this report in plain language.

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[3] See IDA Task Force study, Impact of Disclosure on Cost of Capital.

4. The Purpose of Disclosure in Securities Law

Disclosure promotes public policy goals in regulation of the distribution and trading of securities. Most securities legislation in Canada has as its express goals: investor protection, capital market efficiency and public confidence in capital markets. Disclosure allows investors to make informed valuation and investment decisions. It places responsibility for accurate disclosure in the hands of those with the information, who are seeking a wide market in which to raise capital. A first principle is full, plain, true and timely disclosure, creating fairness in access to information.

Disclosure as a policy objective and disclosure as a policy instrument are often conflated in discussions about regulatory change. Yet disclosure performs an important role as both a policy objective and a policy instrument of securities law.

i. Disclosure as a Public Policy Objective

Disclosure is an objective in itself, as it advances the three express objectives of securities legislation, investor protection, capital market efficiency and public confidence in capital markets. Information about an issuer drives market moves; hence it is a valuable good. Rigorous disclosure to the market means that the good is traded based largely on a standard of fairness or fair access to information in order that market participants can make an informed investment decision. As this report discusses in Part 5, the reality is that equal access to information is not a guarantor that information as a ubiquitous good will necessarily lead to fairness in the market, as retail investors have different time, resources and capacity to digest and make use of the information. However, as a normative starting point, access to information that is full, plain, true and timely does create the potential for equal use of that information by market participants. Since the premise of securities law is that the market will reward issuers engaged in effective governance and appropriate risk taking and wealth maximizing activities through the value of shares in the market, consequent credit ratings and other measures, information creates the conditions for those activities to be rewarded. Full and timely disclosure allows individual and institutional investors to invest with confidence in open and fair capital markets.

In terms of the objective of investor protection, the goal of disclosure is to provide timely, accurate and complete information to the market, so that investors can make informed choices based on information about the issuer's activities that is timely and relevant. It is aimed at protecting investors, both when a new issue is brought to the market and on an ongoing basis. Investors seek assurance about the validity of issuers' financial information. Thus an issue is whether disclosure, as it is currently constructed, truly does provide investors, particularly retail investors, with full, true and plain disclosure such that they can make informed investment decisions. One expert in securities law has observed that the purpose of disclosure is to place investors, to the extent possible, on parity with the issuer in terms of information available; hence, disclosure requirements protect investors as they are an equalizing force, creating a more level playing field for market participants and facilitating better decision making.[4]

However, implicit in the linking of disclosure with investor protection is the assumption that investors with fair access to information will make rational choices, rational in this context meaning the capacity to use the information disclosed to act in their own best interests in market transactions. Behavioural economics has questioned whether disclosure in itself is sufficient to overcome particular human decision-making tendencies that inhibit the ability to be rational in market transactions.[5] While this concern is not part of a regulator's mandate, it is important to keep in mind the limits of any disclosure regime in terms of believing that there is a model that perfectly protects investors. Moreover, it is important to note that investors will draw different conclusions about the same data, which is why there are buyers and sellers on the same day, and hence the real issue in respect of disclosure is whether disclosure is of sufficient quality and quantity to allow investors make to investment decisions or assess investment advice.

Disclosure as a policy objective also enhances capital market efficiency because it can ensure timely and effective dissemination of information that is material to investor decisions, and facilitates the raising of capital in a cost-effective and timely manner. Lack of certainty in requirements can create costs for issuers and unnecessary disclosure and its attendant costs because of liability chill. Excessive regulatory intervention can work to diminish meaningful disclosure either by flooding the market with transient information or creating unwillingness to disclose because the particular information does not fit within one of the "statutory boxes" requiring disclosure. In contrast, a well-designed, accessible system can facilitate issuer disclosure and investor decision making, resulting in more efficient trading.

In turn, disclosure advances public confidence in capital markets. The quality of disclosure can influence market behaviour, as the willingness of investors to expend their capital on domestic economic activity is

[4] Glorianne Stromberg, "Disclosure", Queen's Business Law Review at 293, 300, quoting debates on the bill that became the U.S. *Securities Act of 1933.*
[5] For a discussion of this issue, see John R. Nofsinger, *The Psychology of Investing* (Upper Saddle River, NJ: Pearson Prentice Hall, 2005); M. Condon, A. Anand and J. Sarra, *Securities Law in Canada*, (Toronto: Emond Montgomery, 2005) at 87.

affected by whether there is confidence in the disclosures being made. Failure to achieve effective disclosure can reduce market efficiency because the cost of raising capital is higher and public confidence and willingness to invest is diminished.

ii. Disclosure as a Public Policy Instrument

Disclosure is also an important policy instrument in three respects: as a transaction cost control device, a regulatory tool and governance signalling device.

As a policy instrument to control transaction costs, disclosure can serve to reduce the cost of access to capital. Disclosure can enhance efficiency in capital markets by reducing the costs of contracting for securities, including the cost of contracting contingency claims. Standardized disclosure requirements reduce transaction costs for issuers bringing securities to the market, particularly where there is uniformity in requirements. These costs include third party costs incurred in the raising of capital, such as fees, and the pricing of new capital in the market. Transaction costs, however, can vary given the frequency of rule changes, the amount of codification, and whether the rule change enhances confidence in the market. A particular level of codification can increase certainty and reduce costs; however, over-codification or rapidly changing standards can increase transaction costs as issuers scramble to understand and meet new requirements or market participants seek premiums for investment.

Disclosure must also be adaptive to changes in market perception or demand. A good example is reduced investor confidence in the wake of corporate and securities scandals in the U.S.. Both the U.S. and Canadian systems were required to respond to reduced confidence; and numerous transparency measures were a critical component of that response. In this instance, the transaction costs of winning back investor confidence were substantial, however, these costs had to be balanced against the costs to the market overall from investor exit.

Second, disclosure is a policy instrument in that it is a regulatory tool under the current Canadian system that serves as a measure of compliance with regulatory requirements. Disclosure has become the benchmark for assessing issuers. Regulators assess fitness for market based on the issuer meeting disclosure requirements; this regulatory approach has been adopted rather than a system based on an assessment of the merits of the particular product being offered. Disclosure is also the regulatory instrument for sanctioning or removing market participants.[6] It is also a tool for the creation of appropriate incentives for behaviour by capital market participants. For example, those issuers with recognized experience in the market and a history of compliance with securities law requirements have less onerous regulatory conditions imposed on them in bringing a new offering to the market. Hence there is an incentive to comply in order to reduce costs of future offerings. In this sense, disclosure is a regulatory tool to facilitate creating a culture of both pro-active disclosure and of compliance.

Finally, disclosure has a corporate governance role in that it is a signalling device, communicating messages to capital market participants in respect of the effectiveness of corporate governance of the issuer. It is a signalling device for corporate directors as it allows the board to assess upside and downside changes and risks, and adjust its strategic planning and oversight accordingly.[7] It serves as a signalling device for investors in respect of operational efficiency, director oversight and managerial skills. Increasing disclosure of governance practices under "comply-or-explain" policies of stock exchanges and securities regulators, means that there is increasing information about governance practices, contingency processes, insider trading decisions, executive compensation, and board independence measures.[8] However, as discussed in Part 7, the extent of regulatory intervention may impact the effectiveness of disclosure as a signalling device.

Hence disclosure as both a policy objective and a policy instrument is important to consider in exploring the extent to which current disclosure requirements assist in the statutory objectives of securities law.

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[6] Its use as a deterrent or compliance tool has been contested. An important discussion but beyond the scope of this report.
[7] Condon, Anand and Sarra, *supra*, note 6 at 348.
[8] J. Sarra, "Oversight, Hindsight and Foresight: Canadian Corporate Governance through the Lens of Global Capital Markets", in J. Sarra, ed., *Corporate Governance in Global Capital Markets,* (Vancouver: UBC Press, 2003) at 42.

5. <u>A Framework for Thinking About Disclosure</u>

Consideration of future options to modernize disclosure policy must be situated in the context of current national debate regarding the future structure of securities regulation. Structural reform decisions will inform disclosure efficiencies, but the need for effective, timely and cost effective disclosure will likely drive the harmonization debate.

The framework must recognize that the disclosure regime underpins securities law, and transparency and fairness are critically important to modern securities regulation. While one could explore whether a framework other than one that is disclosure-based should be devised, the reality is that disclosure is the underpinning of all major jurisdictions (if not all jurisdictions) internationally. Given the need for Canada to compete in global capital markets, disclosure as the key underpinning of the existing framework is currently the only realizable short-term option. Any paradigm shift could only realistically be contemplated after extensive international debate.

In order for the existing framework to be effective, however, it must consider costs, benefits and risks of the current disclosure regime, and consider appropriate adjustments that further promote the objectives of the legislation. Different standards of disclosure add to costs of securities regulation and increase risks to capital market participants. Delays in approval of disclosures can result in opportunity costs. Inefficiencies in disclosure can increase the cost of raising capital. Duplication in meeting regulatory requirements and the costs of ensuring compliance across jurisdictions, including maintaining currency with different jurisdictional requirements, can jeopardize market activity.

Hence, the disclosure-based framework has a direct impact on standards of investor protection and cost of access to capital; and an indirect impact in terms of competitiveness in global markets. An effective disclosure regime must address information asymmetries, the transaction costs of production and dissemination of information, and the costs of enforcing compliance with disclosure requirements. Another consideration is the quality of disclosure, in terms of both enhancing the integrity of the system and creating incentives for ethical behaviour by capital market participants. In turn, high quality disclosure will continue to instil confidence in the system.

i. Impact of Choice of Regime

Within this framework, the choice of regime also has a profound impact on how disclosure policy is developed, implemented and sustained. For example, the development of national instruments and policies by Canadian securities regulators recognizes the intertwined nature of capital markets, and at least to some extent, the need to align with U.S. requirements. The national instruments create greater consistency in disclosure requirements, which in turn is likely to enhance competitiveness for capital. Harmonization of disclosure requirements can reduce costs to issuers in terms of recognition in the U.S. through the Multi-jurisdictional Disclosure System (MJDS).[9]

However, the current initiatives may not sufficiently recognize the cost barriers to small- and mid-cap issuers in terms of compliance. Only 13% of TSX listed issuers are inter-listed in the U.S., and requirements that impose U.S.-type disclosure requirements on smaller issuers may be unduly burdensome.[10] At the same time, obligations on small- and mid-cap issuers need to be weighed against the objective of investor protection. As will be discussed in Part 8, the U.S. is currently rethinking its *S-Ox* 404 rules application for micro-cap and smaller-cap issuers. Equally, Canada needs to balance the impact of costs of compliance for smaller issuers and the risks attendant with less rigorous disclosure requirements.

The establishment of the Mutual Reliance Review System (MRRS) in 1999 increased cooperation between Canadian regulators and appears to have reduced some costs of capital.[11] MRRS allows the issuer to ask that one regulator act as principal regulator, allowing securities regulators to rely on the review and analysis of a regulator from a different provincial or territorial jurisdiction in approving a prospectus.[12] The ability to rely on another jurisdiction as an option, rather than a requirement, is an identified problem of the system, although there is increasing co-operation and deference under MRRS. An additional benefit has been that it has encouraged some convergence of prospectus disclosure, despite the fact that harmonization of standards was not an express goal of the MRRS. There continue to be costs associated with fees and compliance in multiple jurisdictions; and waiting times for approvals may reduce competitiveness internationally.

In a study of costs of compliance conducted for the Wise Persons Committee, the authors found that there was little empirical evidence to determine the efficiency effects of duplication of compliance costs,

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[9] NI 71-101 *Multi-jurisdictional Disclosure System.*, in force November 1, 1998 (1998), 21 OSCB 6919.
[10] BCSC News Release, 2004, http://www.bcsc.bc.ca/news.asp.
[11] For an example of adoption of MRRS, see Québec *Act to Amend the Securities Act and other legislative Provisions,* Bill 72, in force December 17, 2004.
[12] National Instrument 43-201 *Mutual Reliance Review System for Prospectus and Initial AIFs-Amendments* (2002), 25 OSCB 487, amending NP 43-201.

including disclosure compliance.[13] However, the study found that there are opportunity cost risks when decisions regarding primary market offerings were delayed across different jurisdictions.[14]

a) Passport system

One of the most recent developments in the choice of regime issue is the agreement by all securities regulators except Ontario in September 2005 to adopt a passport system through Multilateral Instrument 11-101, *Principal Regulator System*.[15] In all jurisdictions except Ontario, issuers will gain access to capital markets in all Canadian jurisdictions through the regulator and law of its principal jurisdiction. British Columbia, an original signatory to the passport system, has recently placed its new legislation on hold pending further experience working with the other regulators under the passport system. On March 30, 2006, B.C tabled the *Securities Amendment Act, 2006,* introducing new powers to enable the adoption of a comprehensive regulatory passport with other provinces, and permitting further harmonization of securities laws with participating jurisdictions.[16] The amendments are aimed at reducing the regulatory burden on industry by supporting harmonization and giving the British Columbia Securities Commission (BCSC) an array of legislative tools to give full effect to the passport system, strengthening its enforcement powers, and improving the administration of the *Act.*[17]

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[13] A. Anand and P. Klein, "The Costs of Compliance in Canada's Securities Regulatory Regime", in Doug Harris, ed., *Committee to Review the Structure of Securities Regulation in Canada: Research Studies* (Ottawa: Wise Persons' Committee, 2003) 517 at 522; http://www.wise-averties.ca/report_en.html.

[14] *Ibid.* at 521. The study also found that there were costs associated with uncertainty, given the divergence of regulatory reform proposals.

[15] Multilateral Instrument 11-101 *Principal Regulator System*. Effective September 19, 2005, MI 11-101 introduced a passport system for certain areas of securities regulation to all Canadian jurisdictions excepting Ontario. The instrument aims to provide a system that grants market participants access to capital markets in multiple jurisdictions simply by dealing with the regulator and the law of its principal jurisdiction. The passport system follows the *Provincial/Territorial Memorandum of Understanding Regarding Securities Regulation* dated September 2004. Relevant for disclosure are the following features: it applies to areas that are designated as highly harmonized, including prospectus requirements and clearance, prospectus exemptions and continuous disclosure requirements. It designates a principal regulator for continuous disclosure (B.C, Alberta, Saskatchewan, Manitoba, Québec, New Brunswick or Nova Scotia). Specified criteria, including head office of issuer; and if an investment fund, the head office of investment fund manager; or regulator in the participating principal jurisdiction with which the issuer has the most significant connection. Principal regulator is expanded to include all provinces and territories, excluding Ontario.

[16] British Columbia *Securities Amendment Act, 2006,* S.B.C. 2006, c. 32, first reading March 30, 2006, Royal Assent May 18, 2006, parts in force as of May 18, 2006 and other parts waiting for regulation.

[17] The proposed legislation will raise the maximum court fines for offences and the maximum administrative penalty that the BCSC can impose; will broaden the insider trading and front running prohibitions; and expand civil liability for anyone who engages in such illegal trading. It will authorize a provincial court to order the restitution or disgorgement of illegal profits and provide a process for victims to make claims against the disgorged money; BCSC Release, March 30, 2006, http://www.bcsc.bc.ca/release.asp?id=2997.

The Ontario Securities Commission (OSC) did not adopt the passport system because it endorses, instead, the creation of a single national securities regulator. However, the OSC has been highly involved in the policy discussions regarding the contours of the passport system, even though it is not a signatory to the instrument.

While the passport system impacts a number of issues, its relevance for disclosure is notable. MI 11-101 applies to areas that are designated as highly harmonized, including prospectus disclosure and continuous disclosure requirements. It designates a principal regulator for prospectuses and primary market entry approval, and continuous disclosure in the secondary market. It creates an exemption for reporting issuers in Ontario for both prospectus and continuing disclosure. The primary jurisdiction will be responsible for enforcement of securities law. The passport system will reduce some cost of access to capital and may create more uniformity in standards of investor protection simply from the osmosis that occurs when regulators are considering and approving prospectuses for issuers seeking to raise capital in more than one jurisdiction.

One question raised by the new passport system is whether there will be timely access to decisions by the principal regulator on investigation and enforcement decisions. A further question, given Ontario's position, is how to foster further collaboration among securities regulators in order to enhance competitiveness in global markets and reduce the current inefficiencies attributable to structural differences in the process of different regulators.

In recent years, securities regulators have moved to increased codification requirements for disclosure and other practices of issuers. In part, this move has been to increase certainty of disclosure. In part, it has been to meet new standards promulgated in the U.S. following Enron and a series of other securities and corporate law scandals. Canada currently enjoys enhanced access to U.S. capital markets through the MJDS and there had been concern that failure to move towards the U.S. model would result in losing that privileged access to U.S. markets.

Ontario regulators have been the strongest advocates for increased codification of disclosure requirements. This is significant because approximately 85% of Canadian capital market activity occurs in Ontario. The OSC advanced three concerns in response to the U.S. enactment of the *Sarbanes-Oxley Act,* specifically, that Canadian securities were tightly interwoven with the U.S.; that there was a need to address the spillover effect in Canada from the crisis of confidence in the U.S.; and that U.S. reforms had the potential to strengthen the checks and balances that failed to protect U.S. investors.[18] As a result, the OSC has strongly favoured harmonization with U.S. securities law changes to disclosure requirements. This trend, however, is not unidirectional, as the U.S. is currently shifting to less codification in some areas of disclosure, as discussed in Part 8.

b) Blueprint for a National Model

Ontario has also been the strongest advocate of a national securities regulator. Most recently, it commissioned a report titled *A Blueprint for a New Model*, chaired by Purdy Crawford, one of Canada's leading thinkers and senior statespersons in securities law.[19] The *Blueprint Report* pointed out that prospective foreign investors have difficulty understanding why Canada has 13 securities regulators when it represents only 3.2% of the world's equity capital market and approximately 1.5% of the world's fixed income capital market.[20] The *Blueprint Report* is an implementation recommendation document, building on the findings of the Wise Persons' Committee proposal for national securities legislation.[21]

The Wise Persons' Committee recommended enactment of a new Canadian securities act that would provide a comprehensive scheme of capital market regulation in Canada, administered by a single Canadian securities regulator. There would be functionally empowered regional offices that would be responsible for review and enforcement and contribute to policy development, as well as a separate adjudicative tribunal. On disclosure, the recommendation was to have a single, uniform set of standards and requirements that issuers would be required to comply with, regardless of which Canadian jurisdiction they were located or trading in. The uniformity in disclosure requirements would be aimed at enhanced investor protection and elimination of duplicative costs. To date, the concept has not, however, been embraced by a number of Canadian jurisdictions.

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[18] David Brown, (then) Chair OSC, *Striking a Balance: Why Competitiveness Demands a Fair Market for Both Investors and Issuers* (19 September 2002), http://www.osc.gov.on.ca/en/About/News/Speeches. *Sarbanes-Oxley Act of 2002,* Pub. L. 107-204, 116 Stat. 745 (2002).
[19] *A Blueprint for a New Model*, *A Discussion Paper by the Crawford Panel on a Single Canadian Securities Regulator,* (8 December 2005), http://www.osc.gov.ca.
[20] *Ibid.* at 9, citing the World Federation of Exchanges study of 60 stock exchanges, www.world-exchanges.org and the Bank of Canada Review (Summer 2004).
[21] Wise Persons' Committee to Review the Structure of Securities Regulation in Canada, *It's Time* (Ottawa: Department of Finance, 2003) at 67-68.

c) Continuous Market Access Model

The last factor in thinking about choice of regime and the disclosure issue is the proposed British Columbia (B.C) model of continuous market access (CMA), which proposes a combination of standards-based and principles-based regulation of disclosure.[22] Although the B.C legislation was enacted in 2004, its implementation had been placed on hold. The B.C government announced on February 10, 2006 that it was delaying implementation of its new *Act* until at least December 31, 2007, in order to try to work with other provincial regulators on the passport model.[23] It has, for next period, been pre-empted by Bill 20, *Securities Amendment Act, 2006,* introduced March 30, 2006, which will move B.C toward the passport system and align a number of securities law requirements with those of other jurisdictions. While the CMA model is on hold, there are a number of features that inform the national disclosure debate, and hence they are summarized here.

The B.C model represents outcomes-based regulation. The premise is that rules should be few, simple and clear and should be directly linked to outcomes. The CMA model would replace the prospectus disclosure system for all issuing companies with a streamlined public offering process based on a requirement to disclose all material information at all times.

CMA would permit a public offering to B.C investors based on the issuer's continuous disclosure record, which must always be up to date. There would be no mandatory offering document, only a press release announcing the offering and containing material information about the offering. No underwriter is required and securities can be issued in stages as the market permits. Mining issuers need up-to-date technical reports for properties they are working on. The issuer must have become a public issuer in B.C and its continuous disclosure record, including its annual information form, must be current. The model is aimed at enhancing value for investors by reducing the cost of regulation. It sets standards, not detailed requirements. The premise is that excessive prescription of rules means that market participants follow the letter and not the spirit of the rules; and that excessive regulation can undermine goals of investor protection and market integrity. [24]

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[22] British Columbia's Continuous Market Access Model (*Securities Act*, SBC 2004, c. 43, Royal Assent, not yet in force), http://www.bcsc.bc.ca. See also British Columbia Securities Commission, *New Proposals for Securities Regulation- A New Way to Regulate,* (5 June 2002), http://www.bcsc.bc.ca.
[23] British Columbia Securities Commission News Release, *supra*, note 2.
[24] It is important to note that while the BCSC has been a strong advocate for this model, in part this shift was driven by the larger normative direction of B.C government in respect of deregulation in recent years.

Issuers that are reporting issuers in Canadian jurisdictions other than B.C would still have been required to comply with the requirements of those other jurisdictions to raise capital; accordingly, they would not have been able to rely on CMA for inter-provincial offerings. The proposed model would have provided investors with a right of action for misrepresentation in continuous disclosure documents. CMA would require market participants to exercise judgment in their business practices with the interests of investors and markets in mind, rather than looking to the regulator for instructions. It offered an express market-oriented, problem-focused style of regulation on the premise that regulators should intrude on the market only where demonstrably necessary, and that in setting disclosure requirements, they must weigh the risk that regulatory intervention may hinder market resolution to the problem.

The view is that prescriptive one-size-fits-all requirements can inflict unnecessary costs on market participants and can have little regulatory or business value. Market capitalization of most Canadian public companies is smaller than that of U.S. public companies. B.C's view is that the Canadian economy depends on healthy, dynamic, smaller entrepreneurial companies to thrive; and over-codification may hinder global competitiveness.[25] There is also an expressed belief by B.C regulators that the CMA model promotes a culture of compliance. It is aimed at reducing regulatory costs and increasing timely and cost-effective access to the primary market. To date, the approach has not been endorsed by other jurisdictions.

An issuer-based integrated disclosure model similar to B.C's proposals has, however, been endorsed by some scholars and practitioners. Glorianne Stromberg, for example, has proposed a model aimed at placing all investors on an equal footing and improving the quality of information in the market.[26] She suggests that the current closed system is a legalistic, technical structure fraught with problems because it distinguishes requirements based on who the purchaser is, and in some circumstances, who the issuer is, and fails to sufficiently recognize that securities of the same class are fungible and most trading activity takes place in the secondary market.[27] The issuer-based integrated disclosure model focuses on ensuring that at the time of entry to the market, full, true and plain disclosure of the material facts about the issuer and its securities is made, and that the information is kept current. Stromberg suggests that new offerings would be preceded by a timely disclosure notice with an appropriate delay period to allow the information

[25] BCSC News Release, *supra,* note 11. Its goal is to determine how to measure impact and develop solutions.
[26] Stromberg, *supra*, note 5 at 298; she proposes this model to replace the current closed system.
[27] *Ibid.*

to be disseminated to the marketplace, and by providing a window for regulators or investors to seek additional disclosure if believed to be deficient.[28]

ii. Two Normative Directions for Disclosure

This brief description of choice of regime issues highlights that there have been two normative directions in respect of disclosure policy for Canadian capital markets. On the one hand, is the clear move by most regulators towards increased codification through national instruments, policies and local rules. Such codification is likely to enhance certainty in quality of information. However, one concern is that current codification initiatives are an overreach of regulation of primary offerings. It is estimated that currently 25% of all securities regulation is aimed at the primary market, yet this market accounts for only about 5-6% of all trading.[29] Increased codification can result in an attendant increase in disclosure compliance costs, which in turn means a higher cost of raising capital. Arguably, however, a high level of codification could equally mean that disclosure is not more costly if it drives the system to a level of prescribed disclosure, with little thought and time directed to compliance, thereby generating a tick-the-box disclosure culture. A system in which the issuer must consciously consider and apply a level of disclosure that protects investors could, arguably, increase cost of raising capital.

Even where increased codification requires increased costs, initial high costs of compliance may be controlled once internal financial controls and systems are in place. A further question is whether one can conceptualize better or higher quality disclosure, having regard for its purposes, at less cost. The other problem for greater codification is that it may actually result in increased barriers for retail investors where the disclosure is inaccessible.

The other normative direction is a continuous market-access or integrated disclosure model, as discussed above, premised on the notion that principles-based or standards-based regulation will better promote the goals of investor protection, efficient markets and public confidence in capital markets. The BCSC cost benefit analysis of CMA suggests that the model will be more expeditious and less expensive, which in turn would benefit investors and issuers by lowering costs of raising capital.[30]

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[28] *Ibid.* at 298. Stromberg observes that the model is consistent with the selective review procedures of the CSA that are premised on reducing time reviewing primary distributions and more on continuous disclosure documentation, citing OSC Staff Notice 51-708 *Continuous Disclosure Review Program Report* (2002) 25 OSCB 5555.
[29] CSA Notice 53-302, (2000), 23 OSCB 7383.
[30] BCN 2002/45 BCSC announces results of Cost Benefit Analysis of CMA, November 4, 2002, http://www.bcsc.bc.ca/policy.asp?id=1233.

An integrated disclosure model raises the question of what the inherent risks are where underwriters are not required for offerings. Under the B.C CMA model, underwriters would not be necessary as there would no longer be a prospectus requirement. The B.C government did not perceive the absence of an underwriter's certificate as significant under its proposed model, as the continuous disclosure requirements would provide sufficient assurance to the market.[31]

Does removal of that second check impact investor confidence in the market, or create inappropriate incentive effects for issuers? The prospectus is viewed by some as an important protective mechanism as it provides a point-in-time disclosure on which one can hang liability and hence accountability. Removal of the prospectus may increase some risk of sharp practice by issuers and advisors where there are different disclosure standards. However, the prospectus system, as currently devised, may offer too much protection for issuers, in that they can shirk obligations to update information on the basis that a material fact has changed, rather than a material change to business, operations or capital. As discussed later in this part, judgments about materiality continue to trouble the disclosure system.

In considering whether removal of the underwriter's due diligence and certificate would impact investor confidence in the market, it is helpful to consider other examples where regulators in Canada allow the issuer to make a choice and allow the market to monitor the issuer, such as comply or disclose options with respect to corporate governance; the lack of insistence on quarterly financials vetted by an auditor; and the recent decision not to require that internal control certificates be vetted by auditors. In each instance, the issuer has a capital market pricing decision to make: it can acquire the reputational enhancement and concomitant reduction in cost of capital of complying, including getting an underwriter's certificate on the back page, or it can choose not to move to what might be considered best practices and take the consequent risk of the cost of raising capital being higher. Moreover, there are non-brokered private placements and there are brokered private placements that do not have a full, true and plain certificate. In these exempt market cases, the market is willing to proceed in the absence of such a certificate and the issuer will absorb the private placement costs in the interests of speed to market.

It seems then that, even without requiring underwriter certificates, there may be a market for them in instances where the issuer decides that there is not sufficient information or experience in the market such that it must bolster investor confidence and its ability to attract capital at a reasonable cost through the value connotations associated with an underwriter's assurance. It may be that under a CMA-type system, the market should determine the value associated with underwriter involvement.

[31] BCSC, *supra,* note 32.

If there is elimination of the due diligence associated with the underwriter's certificate, how does one address the assumptions made by retail investors regarding the second check on issuer's activities through prospectus review before an offering is brought to the market? There is some critique that streamlining disclosures or making standards too general inevitably invites issuers to supply less than full and transparent disclosure.[32] There is also the issue of whether costs under CMA are shifted from issuers to other market participants in terms of end of process losses or transaction costs in litigating claims.

Yet if an integrated disclosure system is operating effectively and efficiently, there should not be a risk of inappropriate incentive effects, as issuers' greatest incentive will be compliance.

An integrated disclosure model raises the question as to whether, mid-year-between Annual Information Forms (AIF), the disclosure record needs to be up to date with prospectus type disclosure of all material facts, or only updated with material changes. If one assumes that to achieve a sound basis for quick market access it is essential that the continuous disclosure record of the issuer be continuously brought up to date with changes in material facts, even if those changes do not amount to material changes, the cost of raising capital is likely to be expensive.[33] One approach would be to require only that the most recent AIF include as electronic attachments all the material change statements made since it was issued. The result would be a disclosure document that contained disclosure of all material information when the AIF was written, together with disclosure of all material changes since it was issued. Arguably, if this level of disclosure is already an adequate basis for the secondary market to make investment decisions for 95% of trading, it is a sufficient level of detail for the 5% of the market that involves a primary issue. If this is not sufficient, the policy question is: what are regulators trying to provide to the market in a primary issue that requires an even higher level of disclosure?

If the primary nature of the issue is the reason that an even higher degree of disclosure is required, does this requirement make sense where the issuer is well known to the market? As discussed below, developments in short-form prospectus requirements have begun to recognize that well-known market participants do not need to be subjected to the same degree of scrutiny as those issuers new to the market.

[32] See Part 5, section iv, of this report for a discussion of how underwriting certificates could be utilized in a condensed disclosure document.
[33] See the discussion in Part 5, section vi, of this report regarding differences in material fact and material change reporting under the current regime.

An "AIF plus material change" document would not be an integrated document that incorporates by reference all material information, but there would be disclosure located in one place. Investors would have to compare the material change statements with the AIF in order to ascertain the point-in-time financial and other information, but the access would be facilitated by the attachment of all material change statements to the AIF electronically. This would improve access over the current system, but the "AIF plus material change" document would not provide full, true and plain disclosure in that there could be material facts that are not disclosed.

Hence both normative views have benefits and limitations. There are cost implications to the normative disagreement regarding regulatory approach and the resultant different standards of disclosure. CMA savings could be lost when issuers are reporting issuers in other jurisdictions. Increased AIF costs under the B.C CMA would have been offset in cost savings when the issuer's securities go to the market. However, the B.C model would have been limited to smaller cap companies, given that issuers would be required to meet regulatory requirements in other Canadian jurisdictions and in a number of cases, those in the United States. On the other hand, prescriptive requirements may not adequately recognize that one rule does not fit all.

There are also increased risks in choice of disclosure standard. There is a risk of over-codification in terms of accessibility for both issuers and investors in terms of understanding the nature of the obligations. There is a risk of issuers missing market windows, given time delays in bringing an offering to the market. Hence, a critical question underlying the normative debate is what model best protects investors and what degree of standards-based or rules-based regulation is required to generate a culture of compliance. Can the system provide sufficient disclosure to investors of material information without engaging in overreach in terms of requirements placed on issuers?

a) What's Missing from the Debate?

There is a lack of empirical data on which model will best reduce information asymmetries. While the BCSC has undertaken some cost benefit analysis, there is no existing integrated disclosure system that has tested the model.

Both approaches - continuous market-access and increased codification - claim to create a compliance culture. However, the lack of empirical data means that it is difficult to determine which system will better recognize risks regarding integrity of market participants.[34] Both models adopt a civil liability regime as a complement to regulatory enforcement, discussed in Part 7 of this report.

The BCSC conducted a cost-benefit analysis that suggested that the CMA model provides more expeditious and less expensive access to capital without sacrificing investor protection. The cost-benefit analysis of CMA suggests that completion of an IPO will be up to 19% faster and up to 51% cheaper. Offerings after the first IPO could be up to 56% faster and 82% cheaper, depending on size of the issuer. The BCSC suggests that if this approach was nationally adopted, issuers would save $170 million in net present value over five years in reduced prospectus preparation and filing costs.[35] Issuers would get to market faster, reducing the risk of missing market windows. The study suggested that prospectus costs for issuers listed on the Toronto Stock Exchange (TSX) are directly related to length: each page of additional prospectus disclosure costs a TSX issuer about $29,000.[36] The CMA would eliminate most of those costs. CMA would not only benefit investors by improving disclosure, it would also benefit issuers by significantly lowering their capital-raising costs.[37]

The current system puts great emphasis on prospectus disclosure, but in fact, most issuers rarely disclose to this standard: on average, issuers on the Toronto Stock Exchange file a prospectus only once every eight years and issuers on the TSX Venture Exchange file only once every 15 years.[38] The overall level of disclosure in the market would increase under the CMA model, and would be consistent among all issuers, whether or not they raised capital in a given year.

The BCSC reports that under its proposed legislation, the AIF costs would increase about 11%. This cost would be offset by the benefits of CMA if the issuer goes to market just once every 12 to 15 years. The BCSC reports that issuers spend 87% of their securities law compliance time on areas of regulation already uniform across Canada.[39]

Also missing from the debate is empirical evidence on the cost of compliance under the two systems. There is no comprehensive database of compliance costs in the securities industry, although this is now being addressed by research activities underway at the BCSC, the OSC and elsewhere.

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[34] Another study in the Task Force is examining empirical testing.
[35] BCSC announcement, *supra,* note 31.
[36] *Ibid.*
[37] 270 survey, a 22% response rate.
[38] BCSC announcement, *supra,* note 31.
[39] *Ibid.*

b) The Potential for Convergence

Notwithstanding the different normative approaches to securities regulation and disclosure requirements, the Task Force has the fortunate advantage of deliberating on recommendations at a time when there is the potential for convergence, and has an important opportunity to build on current developments. This is highly significant for policy decisions on disclosure requirements. While this potential is discussed in more detail later in this report, it merits introduction here. Indicia of recent potential for convergence in disclosure include the following:

- NI 51-102 *Continuous Disclosure,* increasing harmonization of continuous disclosure;
- NI 44-101 *Short-Form Prospectus Distributions*, allowing many, if not most, Canadian issuers to bring securities to the market on the basis of more efficient and cost-effective disclosure requirements, and moving towards more integrated primary and secondary market disclosure;
- Announced changes by the CSA on March 10, 2006, not to proceed with MI 52-111 *Reporting on Internal Control over Financial Reporting*, and instead, proposed enhancements to MI 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* in terms of finding a compromise between the normative positions of securities regulators on the degree of governance certification; and
- Announcement by the B.C government in February 2006 of a commitment to work towards the passport system, shelving its own continuous market access legislation for almost a two year period and enacting in May 2006 the *Securities Amendment Act, 2006*, to harmonize definitions and numerous statutory provisions to promote cooperation with other Canadian regulators.

All of these recent initiatives indicate that there is movement by regulators, perhaps indicative of a willingness to find common ground in the next stage of modernization of disclosure and of securities regulation more generally.

iii. Fragmentation of Information

Under most jurisdictions in Canada, primary market disclosure is contained in several documents, notably the prospectus and the AIF. For specialized offerings, such as the prompt offering prospectus, the information is disclosed in the prospectus, the AIF, the financial statements and any material change reports.[40] This can lead to fragmentation of information, particularly with the increase in web-based disclosure.

In secondary market disclosure, information is disclosed in financial statements, AIFs, MD&As, proxy circulars and material change reports, often located in different places. The titles of documents do not provide a clear indication of the material contained in the documents. There is overlap, duplication and fragmentation. One example is governance disclosures; board information can be located in proxy circulars whereas audit committee disclosures are in the AIF. While there should be cross-referencing of such disclosures, this is not always clear to investors. This fragmentation is costly to market participants and creates inefficiencies in the system.

The different statutory standards of disclosure between primary and secondary market disclosure means that information is located in different places during different periods of the issuers' distribution and continuous disclosure life cycles, often inaccessible to retail investors.

One possible option for a modernized securities system is to locate disclosure in one "living" document that investors can access at any point in the life cycle of the issuer, whether it is making an offer of securities to the market or meeting its continuous disclosure obligations.[41] The current system means that investors do not necessarily get all the information that is referenced in required disclosure, and that they must spend additional time and resources to receive those disclosures, and then have the time, resources and capacity to analyze and apply that information to their investment decisions. Another possibility, discussed in Section v, below, is to have "one-click full access" electronic disclosure.

iv. Full, True and Plain Disclosure as the Benchmark of Effective Disclosure

A critical challenge in thinking about the modernization of securities legislation is how to truly make information accessible, while ensuring that issuers disclose the level of detail and depth that allows analysts to make informed decisions. This question implicates three principal parties to the disclosure: the issuer; the investor; and the other market participants who have their own obligations to responsibly digest, filter and provide opinions on disclosure.

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[40] Condon, Anand and Sarra, *supra*, note 6.
[41] This option is discussed in Part 7, section vi, of this report.

For the issuer, disclosure requirements must be sufficiently clear that the issuer can meet requirements with a reasonable amount of transaction costs and with some certainty as to whether the issuer has complied with the law. There is a need here for plain language in regulatory requirements, so that issuers of all sizes can understand and meet their disclosure obligations.

For the investor, the accessibility of information is critically important. Scholars, practitioners and regulators have identified the problems faced by two types of investors - retail and institutional - and have considered how to reconcile the different information needs of these investor types.[42] Yet with the increased involvement of retail investors in the market, both directly through on-line facilities and through managed investment funds, the nature of investor interests lies more along a continuum of interest, information and sophistication, rather than a two-tier dichotomy between retail and institutional investors. Institutional investors also run along that continuum in that while they are sophisticated investors, they have different interests, time horizons and priorities in their market activity, and hence may have different disclosure needs. For example, institutional investors interested in longer term investments view governance disclosure as an important aspect of the disclosure regime, as these investors are looking at long timelines of investment and are interested in the long term strategic plans of the issuer. These investors use governance and other disclosures as the basis on which to exercise “voice” in activities of the issuer. Full, true and plain disclosure must be tailored to meet a broad range of investor needs.

For investment analysts, retail stock brokers, fund managers and other intermediaries, disclosure is a critical component of the regime and one that is underdeveloped in terms of thinking about the interplay of disclosure and the services provided. Parts of the market are highly dependent on the ability of those advisors and fund managers to decipher complex disclosures and deliver skilled advice to the market. The move to full, true and plain disclosure would enhance the role of intermediaries in creating informational access to investors who would not otherwise have the time, resources or capacity to make informed investment decisions.

To varying degrees, securities regulators have endorsed plain language requirements, with the BCSC making some of the strongest policy statements advocating such change. The B.C proposed model has

[42] As early as the 1930’s in the United States, William Douglas identified that the glaring light of publicity was not adequate, and that retail investors receive small comfort from the balance sheet and compilation of data, which they lack the training to assimilate, W. Douglas, “Protecting the Investor” (1934) Yale Law Review 521. Douglas became the first Chair of the SEC.

plain language requirements, including that disclosure be definite, use unambiguous language and clear organization; and issuers are to avoid jargon, boilerplate language and multiple negatives.

Modernization of securities disclosure requires a regulatory approach that will give real meaning to the words full, true and plain disclosure.

Black's Law dictionary defines "full" as:

> Abundantly provided, sufficient in quantity or degree, complete, entire, and detailed. Having no open space. Ample, perfect, mature, not wanting in any essential quality;

"true" as:

> Conformable to fact; correct; exact; actual; genuine; honest;

"disclosure" as:

> Revelation; the impartation of that which is secret or not fully understood; fully revealing the details of a transaction.[43]

While Black's does not define "plain", the Oxford Dictionary specifies that plain means:

> Clear, evident, simple, readily understood, not elaborate or intricate, unembellished.[44]

Together, these definitions provide a starting point for thinking about full, plain and true disclosure. Disclosure documents should clearly identify their purpose and provide the essential information in an accessible form. Full disclosure requires a level of completeness, in sufficient quantity and degree where the information is material, such that investors can make informed decisions. True denotes a level of correctness, exactness and honesty; and plain means clear and simple and readily understood.

While the regulatory system has focused in recent years on the full and true aspects of this definition, it is the "plain" requirement that has become lost in the current disclosure regime. In part, this is because of the size, complexity and variety of securities offerings and the increased codification of requirements. Inpart, it is because electronic filing or disclosure of particular information has been added incrementally to the system without sufficient consideration of the overall implications for full, true and plain

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[43] *Black's Law Dictionary*, 5th ed., (St. Paul: West Publishing, 1979).
[44] *Oxford Dictionary,* (Oxford: Clarendon Press, 1970).

disclosure, creating new problems for access. An example would be integrating MD&As as a required part of secondary market disclosure or the additional filing requirements that have accompanied new national instruments that aligned Canada's continuous disclosure obligations with U.S. disclosure requirements after the *Sarbanes-Oxley Act* was enacted. These changes have brought more information to the market, working towards the full and true disclosure objectives; however, there have been no concomitant requirements that the disclosures be clear, simple and readily understood.

In thinking about how disclosure could be recast to meet the objectives of full, plain and true disclosure, one needs to conceptualize documents that contain different parts. While the plain language may be necessary for unsophisticated retail investors or those investors without the time or resources to analyze all disclosure documents, disclosure requirements must nevertheless continue to provide analysts, institutional investors, regulators and other market participants with the level of detail that they require to make informed judgments about their investment advice. Detail, however, does not mean that disclosure must necessarily be overly complex. Full, true and plain can mean complete, correct and readily understood information for all market participants. The 1998 Review of the *OSA* found that effective disclosure is the timely, meaningful and relevant dissemination of information to the market in a form that is capable of being understood by investors who are reasonable persons acting reasonably.[45] Part 7 of this report proposes, as one option, the unification of disclosure documents with a disclosure summary sheet aimed at full, true and plain disclosure.

a) Enhancing Education of Investors and Intermediaries

While not strictly within the mandate of this report, it is important to touch briefly on the need for strategies to enhance the capacity of the investing public to understand and act on enhanced disclosure. Investor education is a concomitant investor protection instrument along with disclosure. While enhanced disclosure means accessibility for investors, absent the ability to understand and apply the information to the investor's particular investment objectives, disclosure will not meet its public policy goals of investor protection and public confidence in capital markets. For example, press releases announcing material changes contain only a limited amount of information. Investors may make judgments to buy, sell or hold on the basis that they believe they have full information on the transaction. Education cannot assist investors in making investment decisions, but it can help them appreciate the limits of particular kinds of disclosure documents and assist in skills building to locate more fulsome disclosure.

[45] 1998 Review of the *OSA*, part 17, http://www.osc.gov.on.ca/About/Publications/op_index.jsp.

Perhaps most importantly, investors need to be alerted to the risks associated with various kinds of securities, so that they can make informed choices about participation in the market. While this needed education is not part of the regulatory system of disclosure, it should be a companion public policy objective that will enhance capital markets. A number of regulators have created investor education web-pages to inform retail investors of regulatory changes and other information.[46] These can be a very useful educative tool for regulators to communicate to very broad numbers and types of investors.

It is also important that investor education includes the benefits and limits of web-based disclosure, including skills-building regarding the use of the Internet to access disclosure information and enhance the capacity to benefit from technological advances. At the same time, investor education needs to make current and future potential investors aware of the risks associated with retail investment decisions based on direct electronic access, in terms of the current fragmentation of information on different parts of sites such as System for Electronic Document Analysis and Retrieval (SEDAR).[47]

Enhancing investor knowledge and providing skills to assess disclosures will enhance capital markets. While education does not remedy individual capacity to digest and apply information, it can serve to reduce disparities in processing information. It can also reduce the incidence of completely uninformed decision making. Enhanced education can also assist investors in better determining whether they require or want the services of investment advisors, rather than making decisions themselves when issuers disclose material facts or material changes about their operations. Education can provide investors with a greater appreciation of their own limits (time, resources and information) to making investment decisions without the assistance of knowledgeable advisors.

Stromberg observes that many investors assume that the intermediary's education and proficiency has qualified her or him to make fundamental decisions for the investor in advance of sending the investor a prospectus and that any licensing or accreditation has meant that all due diligence inquiries appropriate to the investment decision have been met and that there are no conflicts in interest; she suggests that this can lead to an abuse of trust.[48]

Realistically, the vast majority of investors do not make investments themselves; rather, they retain retail stock brokers, mutual fund managers or others to provide them with advice or to direct their investment

[46] See for example, the investor education page of the OSC, Investor Education Fund, http://www.investored.ca/.
[47] SEDAR is the System for Electronic Document Analysis and Retrieval, in respect of electronic filing of documents, National Instrument 13-101 *System for Electronic Document Analysis and Retrieval*.
[48] Stromberg, *supra*, note 5 at 305-6.

portfolio. For individual retail investors, although technically it is the investor that makes the actual decision to buy, sell or hold, in reality it is the analyst that is often the *de facto* investment decision-maker because of time, resources and access problems that retail investors face. Hence, it is important that the intermediaries fully understand and can navigate issuer disclosures in order to give the best possible advice. For analysts, educational training can enhance their capacity to provide advice to clients, in terms of fully understanding and advising on choices for their clients based on the disclosures.[49] The 1998 Review of the *OSA* discussed the need for better education of the financial intermediaries that provide investment advice and financial planning services.[50]

b) The Role of Underwriting in Disclosure Reform

As noted above, the B.C continuous market access model would eliminate the requirement for underwriters for a new offering. Underwriters under the current system offer credibility to issuers, using their reputations as experienced market participants to bolster the disclosed claims of the issuer. A prospectus must contain a certificate signed by the underwriter(s) in a contractual relationship with the issuer whose securities are being offered by the prospectus that to the best of the underwriter's knowledge, information and belief, the prospectus contains full, true and plain disclosure of all material facts relating to the securities offered by the prospectus.[51] The certification provides a second check on the issuer's claims regarding the securities and its underlying financial status and business plan. To some extent, it may create greater access to retail investors, in the sense that there has been a third party assessment of a complex set of disclosure, with the underwriter certifying that that to the best of its knowledge, information and belief, all material facts are contained in the prospectus.

The liability provisions provide some comfort to investors.[52] While underwriters are not held to the same standards in their certification of prospectuses as issuers, (because issuers have direct access to the information), underwriters are nonetheless required to certify based on acquiring the information,

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[49] 1998 Review, *supra,* note 46 at sections 14, 15; it made recommendations on the training and proficiency of securities analysts and other intermediaries. It also made a number of recommendations regarding the development of common standards relating to the performance of managed products, uniformity or comparability in information, regulation of communications aimed at sales, and other recommendations to ensure a higher level of consistency and accessible regarding intermediaries dissemination of information; *Ibid.* at sections 16, 17.
[50] 1998 Review, *supra*, note 46 at sections 14, 15.
[51] See for example, s. 59(1), *OSA;* s. 117 of the *Alberta Securities Act;* s. 63(6) *Nova Scotia Securities Act*; and s. 53 of the Manitoba *Securities Act.*
[52] See for example, section 117, Alberta *Securities Act.*

questioning relevant and material facts, and exercising a high degree of care in investigation and independent verification of the company's representations.[53]

The elimination of underwriting for primary market disclosure may remove an important gatekeeping function from the market. While underwriters are private market participants, the due diligence of underwriters and the fact that they have frequently given the issuer some governance advice suggests that underwriters perform a public policy function. This suggestion is bolstered by their responsibility to ensure that the integrity of the system is maintained in their dealings with the issuer. On the other hand, if the vast majority of purchases in primary market offerings are through intermediaries, then perhaps there is merit in bolstering the due diligence disclosure responsibilities of those intermediaries and eliminating the costly underwriting process.

In addition to the enhancement of the issuer's product issue, there is the public policy issue of whether the system should insist that a gatekeeper, i.e. the underwriter, be associated with any securities issue. That might be the case with an IPO; however, since there is no mandatory underwriter certificate on an AIF, nor on any material change statement, and since 95% of the market trades daily on the strength of information that no gatekeeper authenticates, there may be no significant policy rationale in requiring an underwriter's certificate on an issue beyond the original IPO.

The role of underwriters in respect of disclosure must also be considered when their interests conflict with the investor protection function. For example, under a "bought-deal" underwriting agreement, the underwriter has committed to purchase all of the securities to resell them in the market. While bought-deal arrangements indicate a high degree of confidence in the value of the securities, the risk of a narrower spread in the resell price, may raise conflict of interest issues *vis a vis* decisions regarding disclosure of material facts or events and whether they constitute material change within the meaning of statutory disclosure requirements. Moreover, since under a bought-deal arrangement, the underwriter is the seller of the securities, not the issuer, the purchaser has no remedy of rescission against the issuer for misrepresentations based on the issuer's financial forecasts.[54] While arguably, this is not a serious concern as the underwriter, as direct purchaser, would have the right, the investor as the party that suffers the loss has a more limited remedy if the underwriter declines to act.

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[53] *YBM Magnex International Inc.* (2003), 26 OSCB 5285; *Re A.E. Ames & Co. Ltd.* (1972), OSCB 98; *Feit* v. *Leasco Data Processing Equipment Corp.*, 332 F. Supp. 544 (EDNY 1971).
[54] Although there could be a claim for damages.

Securities regulators have turned their minds to potential conflicts of interest in respect of underwriting services, to try to ensure that investors purchasing securities in the course of a distribution purchase those securities at a price unaffected by conflicts of interest and on the basis of full, true and plain disclosure. NI 33-105 *Underwriting Conflicts* attempts to address conflicts of interest raised by the high concentration of the financial services industry in Canada and hence the risk of conflict, including underwriter disclosure of the relationship between the underwriter and the issuer, and in some instances, the requirement for independent underwriting involvement.[55] While this requirement is aimed at greater transparency of conflicts, any move away from the use of underwriting must take account of the gatekeeping function that has been performed in disclosure assurances and provide for a similar safeguard in any replacement regulatory scheme.

Moreover, if other reforms to the disclosure regime do not move the Canadian system toward full, true and plain requirements, as discussed in other parts of this report, then the role of underwriting continues to be highly important in terms of providing the investing public with expertise on the quality of the disclosures.[56]

v. Technological Developments as a Critical Aspect of an Enhanced Disclosure Regime

In thinking about choice of disclosure regime, it is critical to remember that methods of communication of disclosure have radically changed. Whereas historically, the paper prospectus has been the principal protection device, paper generally has been replaced by electronic and web-based communication. In securities law, however, the move away from paper has not been fully developed, in part, because of the assurance that paper gives in terms of holding issuers and others accountable for the disclosures made. However, web-based and electronic disclosure raises questions about the continued efficacy of a paper-based system. The issue is how to use technology to maintain and enhance the quality and timeliness of disclosure.

The exponential increase in use of web-based platforms and other technology has quite literally revolutionized access to information. Investors today can access information about issuers through the SEDAR, the System for Electronic Disclosure by Insiders (SEDI), stock exchange listings, company

[55] NI 33-105 *Underwriting Conflicts* (2001) and Companion Policy 33-105CP to NI 33-105 *Underwriting Conflicts*, 24 OSCB 7696.
[56] See discussion in Part 5, section iv, of this report regarding the potential role of the underwriter an integrated disclosure regime, in terms of summary and other documents.

websites, electronically posted information about legal actions that the issuer is involved in and a host of other portals through which information is now disseminated.[57]

However, these systems are not always accessible. For example, disclosures filed on SEDAR are posted in multiple places on the website and it takes a certain amount of time, talent and tenacity to find an issuer's AIF and then all of the filed material change reports since it was posted. There is not one required place where all material information is located and organized in a coherent fashion. Hence while it is helpful to have a central repository of information, the cumbersome and time consuming SEDAR site needs to be revamped to become more accessible to investors. Some investors may believe that they are making decisions based on full and complete information, where they have missed an important material change report buried within the site. Although there appears to be no empirical evidence as to how widespread this problem may be, regulators confirmed that this is a reported problem. There is no place in SEDAR that one can access to be assured of complete disclosure. Although most issuers now include such documents centrally on their own website, this is by no means uniformly accessible.

Liberal access to web-based information and communication has created a new tension in the disclosure debate. On the one hand, electronic and web-based disclosures are enhancing the ability of issuers to make full, timely, material disclosure to a broader range of market participants. This protects investors in that both primary and secondary market disclosures are more accessible. Timely disclosure increases market efficiency as it allows the market to respond to earnings statements or material changes rapidly, and alerts all market participants to developments that may influence their investment decisions. While there may be some concern regarding access to web-based disclosure, this concern is less and less likely to be a justification for maintaining the current paper-based system, as those engaged in securities markets are increasingly likely to have web-based access to information.[58]

On the other hand, there is a risk that information that is accessible but almost ubiquitous will reduce true access to information for investors, particularly with the use of hyper-links and different web-platforms, all of which can obscure, rather than create, ready access to information for investors. Hyper-links can perform an important disclosure role in directing the investor to the appropriate place in the disclosure documents, where an issue is more fully discussed. The more sophisticated the delivery, the more exciting the delivery (for example, shifting to footage of research and development or recent resource discoveries),

[57] CSA, SEDI, http://www.csa-acvm.ca/html_CSA/sedi.html.
[58] While the disclosure is less costly to issuers, there would be a cost transferred to investors if they were not to have access to paper disclosure on request, as those that wished to download and print would bear these costs directly, at a higher per page rate than mass production by the issuer.

but the greater the risk of missing important information. Hyper-links can also take the investor to related web-addresses where other parties are making the disclosures. In such cases, it is not always clear that the investor is leaving a website for which the issuer assumes responsibility and exiting to another site not within its control in terms of accuracy and completeness of information. This needs to be addressed in thinking about the move to web-based disclosure. If the medium is part of the message, it is important to consider how transparency and accessibility of information could be affected by a primarily web-based disclosure regime.

There is no reason why electronic and web-based disclosure cannot be fashioned to provide the entire continuum of investors the same level of disclosure at the same time. It would allow retail investors to make investment decisions themselves, without relying, where they choose, on investment dealers, advisors and other intermediaries to provide that information and advice. However, regulation of this type of disclosure system would have to make clear any rules with respect to issuer accountability or liability for hyper-links and other electronic and web-based links.[59] Any rules devised must be tailored to specific public policy goals.

For example, there could be a requirement for "one-click full access" to all current filed information of the insurer. Whether this should be the responsibility of the CDS or of issuers individually is a matter of public policy choice, and there are costs associated with placing the onus on a particular market participant. However, a "one-click" system that would take the participant to all current disclosed information of the insurer would greatly enhance current electronic disclosure. The potential cost savings to investors could be significant, in terms of the cost of accessing the information and reducing losses due to uninformed decisions. It would also provide regulators with a more accessible means of monitoring market participants.[60]

The shifting role of institutional investors in governance of the issuer has also created new types of access questions. In a sense, full and timely electronic disclosure creates some parity with institutional investors, whose access to the issuer and the issuer's board room has grown considerably in recent years. While there may be some disagreement with this premise, in that access of institutional investors has now been somewhat retrenched, as a policy matter e-delivery of disclosure is a levelling influence.

[59] For example, a mandatory condition that the investor be warned that she or he is exiting the issuer's site and is not in control of or responsible for disclosures on the site to which the investor has been directed. However, even in such a case, should the issuer be directing investors to a site that it may be concerned about the quality of disclosures?

[60] The availability of new mechanisms for disclosure regulation should also facilitate regulators considering current settlement timeframes, in terms of how trades are processed.

Web-based communication also allows investment dealers and other intermediaries to access information on a timely basis and to digest, analyze and disseminate that information to their client base in a timely manner. Historically, the market was structured so that these participants were able to access disclosures more readily than retail investors and hence differential access created a market demand for their services. Increased direct access may diminish that traditional market. At the same time, there is a growing demand for investment advice as the range and diversity of products increases. Hence better discipline in respect of web-based disclosure should enhance market choices overall. Electronic disclosure may also create greater incentives for analysts and other market participants to maintain or enhance the quality of their advice, as retail investors will have the option of accessing the market directly.

A number of web-based, electronic or technology-based initiatives have enhanced access to disclosure in recent years. Electronic road shows are increasingly available, allowing investors from remote locations to access information meetings and ask questions about securities being brought to the market. Another example is the growing practice of advance notice of earnings announcements, with the electronic capacity to be on-line for the announcement or to hear the announcement on a deferred basis but first-hand. These are examples of the market being ahead of the regulatory system, through the use of e-delivery on road shows and call-in numbers that are accessible to retail investors. It highlights that electronic disclosure is now part of the market, and regulators should not be hesitant to use these advances to promote enhanced quality and timeliness of issuer disclosure.

Creating access to analyst calls, where the issuer discusses particular issues with analysts, is also a positive development in disclosure access, whereby retail investors can now access calls. While most individuals do not have the time or resources to follow analyst calls, the participation of intermediaries and some investors is likely to help ensure that inappropriate or unfairly advantageous disclosure does not occur. For those with the time and resources, it may enhance investment decisions.

Here too, however, the choice of where to locate all the disclosure is a critical one that may affect the market. If a “one-click full access” system was the responsibility of individual issuers, the costs could become quite onerous in terms of IT support. However, more than 90% of TSX listed companies already maintain web-based disclosure, and hence a number of the design and development costs have already been expended. Alternatively, “one-click full access” could be located in a revamped SEDAR. Here, the issue is how to ensure a level playing field in access to disclosure.

For example, CDS INC., which operates SEDAR on behalf of the Canadian securities regulatory authorities, offers a new service on its own website called SEDAR-SCRIBE. It is a service that gives subscribers immediate disclosure of SEDAR filings, 12-24 hours before they are posted for the general public. CDS markets SEDAR-SCRIBE as an electronic data feed service of CDS INC. that is "the only comprehensive wholesale source for Canadian public company and investment fund filings", a "subscription service that electronically delivers SEDAR filings on a near real-time basis", customized to the subscriber's needs.[61]

Arguably, this could be creating a two-tiered electronic disclosure system, with more timely disclosure for those market participants that can afford to pay. If disclosure is a good that as a public policy we want to be uniformly accessible, then the appropriateness of this service may have to be examined.

The amendment of corporate statutes that allow electronic disclosure of proxy and other information and web-based shareholder voting is another disclosure enhancing development, improving access to information and the ability to act on that information.

A consequence of more universal access is that the upsurge in quantity of information often means that the information is publicly disclosed through multiple sources, and it is difficult for investors, particularly some retail investors, to accurately acquire a full picture of the issuer's activities and risks to business. It can also be difficult to assess how material or significant the disclosure is. Although the periodic disclosure documents such as financial statements, AIFs and MD&As are required to periodically give a full picture, in the interim periods, material charge and other reporting can be located in a myriad of places, and can give mixed messages to investors about the risk and return decisions faced by an issuer. While issuers may be making good faith and diligent attempts to ensure that the only information in the market is that which is timely, accurate and material, the administrative requirements involved in maintaining multiple disclosures can create additional costs and risks for issuers.

While there is a continuum of investor interest, and a growing number of retail investors directly managing their portfolios, the majority of retail investors will continue to rely on investment dealers and others for advice. Frequently, investors make decisions based on a phone call or e-mail, and without the benefit of having seen the prospectus. Investors may not receive the prospectus until after they have used an intermediary to make an investment decision. While they have a limited window to change their mind

[61] http://www.cds.ca/cdshome.nsf/Main-E?OpenFrameSet&Frame=content&Src=Pages%2F-EN-SEDAR-SCRIBE%3FOpen.

on receipt of the prospectus, the reality is that unless investors determine that there was egregious material information they were not aware of, they are not going to expend the time and resources to cull through the prospectus and then exercise their withdrawal rights.

Technological change has facilitated more immediate disclosure, and mandating electronic delivery of a prospectus prior to a purchase decision is one policy option. However, if investment decisions by many retail investors are not currently made on the basis of carefully reading the prospectus, such a requirement may not accomplish the goal of enhanced disclosure to investors before the purchase decision is made. Another option is a plain language summary document, discussed in Part 7, which would be required to be sent to the investor prior to the issuer, investment dealer or other participant accepting a purchase decision.

Notwithstanding that there may be a lingering concern that some investors domestically and globally do not have consistent access to web-based disclosure, the system could shift to a default-based system, whereby investors receive notice of web-posting of documents, with the appropriate web-links. While e-systems are likely to take some time to perfect, it is, arguably, better to enter the field and then perfect its use than to languish behind market developments. Where investors ask for paper copies, the issuer would make them available, with the rest of investors accessing the disclosure on line. Another option is that instead of the issuer being required to provide print versions, the investor would be able to get a print version from their registered representative as part of the package of services offered.

Web-based or electronic communications platforms allow for reduction of information asymmetries and enhanced timely, extensive disclosure that is accessible to everyone seeking to participate in the market. In combination with access to paper disclosures, it can promote the public policy goals of disclosure, enhancing investor protection, market efficiency and public confidence in capital markets.

Given the technological developments in recent years, it is timely for securities regulators to consider how to move disclosure into a system that takes full advantage of technological developments. It may also be timely to seriously consider once again whether access does equate with delivery, and how the system should be fashioned to ensure that investors are fully informed based on materiality requirements, in as full, accessible and timely a manner as possible. This includes disclosure about business, operations and capital structure of the issuer.

However, if web-based disclosure access is to equal delivery of the prospectus or another document for purposes of primary market disclosure, it is important to build in the same level of investor protection. This includes measures that guard against information tampering. It is also important that regulators are able to efficiently monitor disclosure, given its function as a regulatory tool. Yet, design of a system that allows certainty in tracking, especially disclosure as ephemeral as electronic information, will require some care. Attention will also have to be paid to how securities holders can establish delivery or non-delivery of information. While deemed reliance provisions alleviate some of this concern, it may become a practical challenge in establishing the timing of issuer disclosure on a particular matter.

As discussed in Part 8, the U.S. SEC is experimenting with a new electronic disclosure platform, XBRL.[62] The U.S. platform allows investors, analysts and other market participants to draw down information electronically and more easily appreciate the nature of the disclosure through "tags" that allow the customized selective retrieval of data based on type, i.e. revenue, assets, etc., all pulled up on a single page that the investor can then analyze. Success of this pilot may signal a new era of web-based disclosure.

Technological developments can reduce the cost of delivery for issuers. However, it is unlikely to be a cost savings overall, as moving to a fully integrated web-based or electronic disclosure system requires full time ongoing IT and IP support, to ensure that continuous disclosure is accurate and timely. Requiring all continuous disclosure to be housed in one location, perhaps the issuer's web-page, would, however, address the fragmentation problems discussed earlier in this report.

One question is whether there should be a market for centralizing data for investors. While this might provide an accessible service for investors, there is also the public policy issue of preservation, storage and retrieval of that data in case of compliance or civil liability issues.

Even without the use of centralizing data services, investors may face difficulty in pursuing civil liability claims based on electronic documents that they did not download at the point in time for which they later seek to impugn the disclosure conduct. Absent paper-based copies, the system design will need to ensure timely and cost-effective access to that point-in-time disclosure or there will be enormous transaction costs associated with litigating access to "disclosure of the point-in-time disclosure".

[62] "eXtensible Business Reporting Language" (XBRL), a new business reporting language developed by an international consortium of 400 major organizations. See discussion in Part 7, D.

Similarly, while some technology would allow for customization of document disclosure for particular investors, one needs to be concerned about disclosures that alter first-hand disclosures by issuers and may diminish the ability of investors to hold them accountable for the disclosures. Hence the adoption of new technological strategies must take account of these concerns. The issue is what use of technology will enhance disclosure and promote the objectives of securities legislation. The responsive capacity exists, but it needs to be implemented in a manner that allows issuers cost-effective disclosure delivery while protecting investors of all kinds along the continuum of sophistication and interest.

There should also be consideration of how regulators' use of technology assists in disclosure requirements, and many regulators have enhanced their capacity in that exercise. For example, the BCSC has made significant changes to the online exempt distribution report system. The online filing of exempt distribution reports, coupled with online payment by electronic funds transfer, eliminates paper processing and related costs, enhancing market efficiency.

One additional issue is the fragmentation of regulatory disclosures. Market participants have difficulty accessing the most recent consolidated version of national and multilateral instruments and policies. The OSC and other sites do not always make clear which instruments or rules have been superseded or updated. One solution would be to bifurcate electronic posting into all current consolidated rules, instruments and policies, and then create an archive of all other policy documents and rules.

vi. Materiality

Material fact and material change disclosure are key features of current Canadian securities regulation. The requirement of materiality disclosure is tempered by requiring that the material fact or change is reasonably expected to have a significant effect on the market price or value of the securities. This is a market impact test, rather than a reasonable investor test, as exists in the United States. While Canadian statutes require differing degrees of disclosure of material facts and material changes at different points in market trading, the TSX rules require disclosure of "material information", arguably a higher standard. New national policy also recommends a material information standard, but to date, the statutes have not been amended to align.

The issue of material information disclosure is likely to become even more important with the introduction of the civil liability regime for secondary market disclosure in Ontario.

A major contested point is whether the current distinction between material fact and material change ought to be eliminated. Even where there is unwillingness to eliminate the distinction, there is some level of dissatisfaction with the definitions as they currently exist. Since the notion of materiality is integrally intertwined with disclosure requirements, the current challenges warrant some discussion.

The Ontario *Securities* Act defines material fact as the following:

> "material fact", when used in relation to securities issued or proposed to be issued, means a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.[63]

Hence material facts are linked to market price or value in terms of disclosure obligations. However, in the context of primary market disclosure, once a prospectus is given a receipt by securities regulators, there is no obligation to update material facts during the offering period, whereas there is an obligation to disclose material changes.[64] Hence the delineation between material fact and material change becomes significant.

Material change is defined in the *OSA* as:

> "material change",
>
> (a) when used in relation to an issuer other than an investment fund, means,
>
> (i) a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer, or
>
> (ii) a decision to implement a change referred to in subclause (i) made by the board of directors or other persons acting in a similar capacity or by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, and
>
> (b) when used in relation to an issuer that is an investment fund, means,
>
> (i) a change in the business, operations or affairs of the issuer that would be considered important by a reasonable investor in determining whether to purchase or continue to hold securities of the issuer, or
>
> (ii) a decision to implement a change referred to in subclause (i) made,
>
> (A) by the board of directors of the issuer or the board of directors of the investment fund manager of the issuer or other persons acting in a similar capacity,

[63] Ontario *Securities Act*, R.S.O. 1990, c. S5, as amended ("the *OSA*") at s. 1(1); for the Québec provisions, see *QSA,* ss. 25, 68, 73.
[64] *Kerr* v. *Danier Leather Inc.*, [2005] O.J. No. 5388 (Ont. C.A.).

(B) by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, or

(C) by senior management of the investment fund manager of the issuer who believe that confirmation of the decision by the board of directors of the investment fund manager of the issuer or such other persons acting in a similar capacity is probable;

As with material fact, one feature of the current definition of material change under the *OSA* and other provincial legislation, except Québec, is that material change for issuers (other than investment funds) is based on a market impact test, not a reasonable investor threshold.

The requirement for full, true and plain disclosure of all material facts is a key feature of the prospectus process. However, the definition of material varies slightly across Canada. As noted, the *OSA* defines a material fact as a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.[65] New Brunswick's provision is identical, both provinces having a definition that is forward-looking, in that it is a fact that would reasonably be expected to have a significant effect on either the value or price of the security.[66]

The Québec *Securities Act* does not require that a fact would "significantly" affect the value. Other provinces have both a prospective and retrospective requirement to disclose, also tied to significantly affecting the market price or value of the security.[67] Hence provincial and territorial legislators have lagged behind securities regulators in terms of creating consistency in standards. While the national instruments and policies developed by Canadian securities regulators have actively moved the regulatory environment towards convergence in disclosure requirements, particularly in respect of secondary market disclosure, the courts still treat these instruments and policies as having less force or weight in their deliberation as to whether a market participant has engaged in misconduct.

In December 2005, the Ontario Court of Appeal released its judgment in *Kerr* v. *Danier Leather*, overturning the judgment of the Ontario Superior Court and making a number of findings that may be significant not only for prospectus disclosure - the issue that was before the court - but also for continuous disclosure.[68] Whatever one's views regarding the judgment, the appellate court findings on material disclosure do raise once again issues regarding definitions of materiality and whether the bright line

65 *OSA,* s. 1(1), *supra,* note 64.
66 New Brunswick *Securities Act*, s. 1(1).
67 For a discussion of the wording of different jurisdictions, see Condon, Anand and Sarra, *supra*, note 6 at 265-266.
68 *Kerr* v. *Danier Leather Inc., supra*, note 65.

drawing between material fact and material change creates unnecessary barriers for investors seeking remedies for harm.

The Ontario Court of Appeal in *Kerr* v. *Danier Leather* held that a prospectus is only required to provide full, plain and true disclosure of all material facts as of the date of the prospectus, not the date of closing. Sections 56(1) and 57(1) of the *OSA* are a complete code of prospectus disclosure for statutory compliance and civil liability purposes.[69] The Court held that an issuer is required to amend a preliminary prospectus if a material adverse change occurs before a receipt for a final prospectus is issued or if material change occurs before the end of the distribution. However, it held that there is no requirement to disclose material facts that occur during this period. On the facts, it overturned the lower court judgment and held that no material change had occurred. The Court held that the Legislature engaged in a line drawing exercise; specifically, that an issuer is required to update prospectuses for material changes but not material facts.[70]

The Court of Appeal in *Kerr* v. *Danier Leather* also strongly endorsed the business judgment rule in disclosure obligations under securities law. A decision can be a reasonable one, not a perfect decision, and directors can select one of several reasonable alternatives. The Court further held that while 51-201 has largely eliminated distinction between material facts and material changes and instead requires timely disclosure of all material information, the *OSA* has preserved the distinction.[71] The Court left open some issues regarding forecasts and the question of reasonable skill and care in making the forecasts, but still held that in most cases, a prospectus can be taken to contain implied representations that the forecast represents management's best judgment that the forecast was prepared using reasonable care and skill, and that management believes the forecast to be reasonable. However, the Court found that there was no implied representation that the forecast was objectively reasonable.[72]

The judgment in *Kerr* v. *Danier Leather* indicates that the precise contours of material fact and material change are not always clear. The issue in the case also involved future oriented financial information, itself problematic in dealing with the issue of whether FOFI are facts. The judgment also squarely raises the question of what role is there for the "business judgment rule" in securities regulation, when there are

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[69] *Ibid*, at para. 60.
[70] The TSX requires timely disclosure of all material information, but the distinction is preserved in civil liabilities rules under the statutory regime.
[71] *Ibid.* at para. 105.
[72] *Ibid.* at paras. 136-142.

statutory disclosure requirements; and what the level of deference to those judgments should be. Both of these issues are addressed below.[73]

The recently promulgated NI 43-101 *Standards of Disclosure for Mineral Projects* also amends the definition of materiality, to be determined in the context of the issuer's overall business and financial condition taking into account qualitative and quantitative facts, assessed in respect of the issuer as a whole and current context (e.g. the effect on market price and value of securities in light of current market activity). In assessing materiality, NI 43-101 specifies that issuers should refer to definition of material fact in securities legislation, and that NI 43-101 aligns timeliness of disclosures with NI 51-102.

a) Is the Line Drawn in the Appropriate Place?

Canadian judgments on the difference between material fact and material change suggest that there is still not a clear or shared understanding by regulators, issuers and other market participants, and the courts regarding the differences between material fact and material change. Has the drawing of a line in terms of disclosure requirements created certainty in the market? Has it unnecessarily deprived investors of relevant information that may affect their decisions to buy, sell or hold securities?

The statutory regime maintains material fact and material change differences, although NI 51-102 suggests a move toward the blurring of these lines for purposes of regulatory compliance. The National Instrument is a move towards a more expansive definition of material information, but here, there is some incongruence with the statutory regime.

In reality, many issuers already disclose to a material information standard. Those listed on the TSX are required to do so.[74] Hence for these issuers, the material fact/change distinction only becomes significant if there is a claim of failure to meet statutory requirements or a civil liability claim. At that point, the issuer and its counsel are trying to slot changes in the material fact category if not disclosed, in order to avoid liability. This seems an inappropriate way to determine statutory compliance. For many issuers, the difficulty is whether and at what point the information is material, not whether it is a fact or a change. The regulatory structure should try to align materiality standards with both industry practice, the TSX standard, and national policy.

[73] For a discussion of the business judgment rule, see Part 6 of this report.
[74] TSX, Policy Statement on Timely Disclosure and Related Guidelines, http://www.tsx.com/en/pdf/PolicyStatementOnTimelyDisclosureNotes.pdf.

The proposed B.C continuous market model would have eliminated the distinction between material fact and material change. The CMA model would require continuous up-to-date disclosure of all material information about issuers, aimed at creating consistency in reporting material information, whether or not issuers raise capital in a given year. The CMA model would eliminate different standards between primary and secondary markets. One question raised by the proposed change is whether adoption of material information will helpfully eliminate bright line distinctions or whether the term is unduly broad such that it might provide issuers too much discretion to determine materiality. However, the experience of TSX listed issuers has not resulted in difficulties discerning the scope of "material information", other than the determination of materiality, as noted above.

The B.C material information standard is premised on investor behaviour being based on economic interest; hence the new legislation retained market impact as the benchmark.[75] With the more comprehensive requirement of disclosure, retention of the market impact test may have provided issuers with a higher comfort level in respect of standards to be met. Some have argued that the market impact test is more objective as a measure than the reasonable investor test. Others suggest that a reasonable investor test would better align Canada with the U.S. and other countries internationally, and can be measured objectively based on a reasonableness assessment. Moreover, there can be time lags in market value, such that the market impact test is not truly reflective of whether the undisclosed information was material. It is possible that it is a distinction without a difference, as discussed in Part 8 in international comparisons, given that market impact is used as one factor in determining what a reasonable investor would believe in the circumstances.

Hence there are several aspects to the material disclosure debate. First, the problems created by line drawing in terms of both investor protection and certainty for issuers. The judgment in *Kerr* v. *Danier Leather* indicates that investors' expectations in respect of accuracy of prospectus disclosure may be incongruent with the statutory provisions. Second, the difficulty of issuers knowing when to disclose. Third, the amount of deference that courts should give to issuers' business judgments regarding what is material.

The 2003 Five-Year Review of the *OSA* chaired by Purdy Crawford observed three advantages to broadening continuous disclosure beyond material changes, specifically, that more information would be available to investors, leading to more informed decisions; it would eliminate fine distinctions between material fact and material change that in turn would bring more clarity to the disclosure regime; and that

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[75] *New Proposals for Securities Regulation, supra*, note 23. For a critique of the B.C model in respect of market impact, see Stromberg, *supra*, note 5 at 312.

elimination of distinctions would reduce reliance on the enforcement procedures under stock exchange rules.[76] However, the Review rejected change because of concerns that without the benefit of hindsight, issuers would have difficulty in determining whether to disclose material information; issuers would face a significant burden of continually monitoring matters external to them; and the OSC now has rule-making authority, which will permit it to promulgate specific disclosure requirements.[77] It may be timely to revisit these reasons for and against the move to one materiality standard.

As noted above, there has been some convergence toward a material information standard among regulators and SROs. National Policy 51-201 *Disclosure Standards* recommends that material information be disclosed and the TSX adopted a material information standard for its listed companies almost two decades ago. The lack of a unified standard on the issue of material disclosure is an area that deserves serious attention in the modernization of disclosure requirements.

The Purdy Review of the *OSA* in 2003 considered the question of market impact versus the reasonable investor test and recommended that the Canadian definition be changed to the U.S. test of reasonable investor.[78] It observed that the market impact test may allow issuers to take too formulaic an approach in determining what is material; and that in many cases the reasonable investor standard is often relied on when advising issuers whether to disclose a change as a material change.

It also observed that since reasonable investors are only concerned where a material fact or change would affect the price or value of the security, there is little difference between the tests.[79] The Review Panel based its recommendation for the adoption of the reasonable investor test on the need for increased regulatory harmonization and because it concluded that requiring issuers to contemplate what would be important to an investor was the appropriate standard.[80]

While the reasonable investor test is intuitively appealing, its possible adoption as the measure of disclosure needs careful consideration, particularly with the introduction of the civil liability regime and the need to balance investor access to remedies for failure to disclose with certainty for issuers.

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[76] Five Year Review Committee Report, *Reviewing the Securities Act (Ontario)*, 2003, http://www.osc.gov.on.ca, (the "Crawford Review"), at 135, 145.
[77] *Ibid.* at 142-147.
[78] Ministry of Finance, *Five Year Review Committee- Final Report – Reviewing the Securities Act (Ontario)*, (Toronto: Queen's Printer for Ontario, 2003) at 148-150.
[79] *Ibid.* at 150. This, of course, precludes any notion that investors also make investment decision based on environmentally friendly or other governance practices.
[80] *Ibid.*

6. Primary Market Disclosure

The materiality debate highlights just one issue in primary market disclosure. Primary market disclosure in Canada has been highly codified for many years. The underlying rationale is that when an issuer first comes to the market, very detailed disclosure allows market participants to assess the risks and benefits of the offering for an issuer that does not have a track record in capital markets or is bringing an offering of securities new to the market. There continues to be fairly broad agreement that regulators need to carefully scrutinize first entry of an issuer to the market. However, for issuers already established in the market that are seeking to make a primary offering, the prospectus disclosure process can be expensive, time-consuming and untimely, with questionable benefits in terms of meeting the legislative objectives of the regime.

Prospectus requirements in Canada set out in considerable detail the information that issuers must disclose when issuing new securities. Prospectus disclosure includes financial statements and a certificate that the prospectus contains full, true and plain disclosure of all material facts as required by the specific securities legislation.[81] The exemption system works to allow issuers with market experience to raise capital on a more flexible and cost-effective basis, without as rigorous a process as the prospectus process.

Québec law requires that the certificate explicitly state that the prospectus does not contain a misrepresentation. Under the *OSA*, "misrepresentation" means:

a) an untrue statement of material fact, or

b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made.[82]

The Court of Appeal in *Kerr* v. *Danier Leather* held that the statutory definition of misrepresentation was central to the appeal, and that misrepresentation can take one of three forms: an untrue statement of material fact; an omission to state a material fact that is required to be in a statement; or an omission to state a material fact that is necessary to make a statement not misleading in light of the circumstances in

[81] The certificate is signed by the CEO, CFO and two directors authorized by the board to sign on behalf of the board, and where there is a promoter, by the promoter.
[82] *OSA, supra,* note 64, s. 1(1).

which it was made. The Court of Appeal found that this third component is aimed at capturing half-truths.[83]

During the process of a primary market offering, there are also continuing disclosure obligations. As discussed above, an issuer must file amendments to the prospectus when a material change occurs prior to the completion of the distribution period; material change is defined as "change in business, operations or capital of an issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer".[84]

In thinking about modernization of disclosure, there appear to be three principal difficulties with disclosure in primary markets. The first is fragmentation of information across multiple documents and the second is the difficulty in discerning the difference between material facts and material changes in terms of meeting prospectus obligations, as discussed above. The third is the lack of integration between the primary and secondary markets in terms of disclosure requirements. Here there is some movement, as evidenced by the new national instrument on short-form prospectuses. There is also a tension between creating access to market issuers by the introduction of short-form, shelf, and prompt-offering prospectuses and accessibility of disclosure for investors.

i. Short-Form Prospectus Distributions - Recent Enhancements

The lack of integration between primary and secondary market disclosure is not static, however, and there are signs of some convergence between the different normative approaches, which would facilitate a more integrated disclosure system. Recent change to short-form prospectus requirements is one measure towards recognizing a continuous-disclosure record.[85] National Instrument 44-101, *Short-Form*

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83 *Ibid.* at para. 112.

84 *OSA, supra,* note 64, s. 75.

85 National Instrument 44-101, *Short-Form Prospectus Distributions* (In force Dec. 30, 2005). In meeting basic requirements is: an electronic filer; reporting issuer in one Canadian jurisdiction; is current in filing obligations in each jurisdiction it is a reporting issuer; in at least one jurisdiction has current financial statements and a current AIF; has equity securities listed and posted for trading or quoted on a short-form eligible exchange (TSX, Tier 1 & 2 TSXV and Canadian Trading and Quotation System); and is not an issuer whose operations have ceased or whose principal asset is cash (s. 2.2). The new rule requires issuers to list in their short-form shelf prospectus all exemptions from NI 44-101 granted to the issuer that apply to its distribution or short-form prospectus. The pre-marketing period for bought deals has been extended from two days to four days before the date of the filing of the preliminary prospectus. Filing requirements include qualification certificate including that all material disclosures under NI 51-101 or NI 81-106, all mining reports and reports of valuation. Unaudited financial statements of issuer or an acquired business or incorporated by reference must have been reviewed in accordance with CICA standards, however, financial statements audited in accordance with U.S. GAAS, International Standards on auditing or standards that meet foreign disclosure requirements may be reviewed in accordance with those other standards.

Prospectus Distributions, in force December 30, 2005, eliminates the seasoning and minimum market capitalization requirements of the former instrument, thus expanding eligibility criteria for accessing short-form offerings to include most Canadian listed issuers. The premise is that the need for such requirements has lessened due to the comprehensive disclosure rules under NI 51-102.

Under NI 44-101, there are exemptions for new issuers and successor issuers in some circumstances in terms of requirements to have a current AIF and current financial statements where the issuer has obtained a receipt for a final prospectus that meets certain conditions, including financial statements for its most recently completed financial year. Broader qualification requirements enable more issuers to take advantage of the short-form prospectus system. The Instrument also facilitates efficient access to capital markets by permitting issuers to rely increasingly on their continuous disclosure record available through the SEDAR. NI 44-101 is aimed at removing duplication and inconsistencies with National Instrument 51-102, *Continuous Disclosure Obligations*, by eradicating the annual information form filing and acceptance procedure featured in the former instrument. It eliminates requirements related to disclosure of significant acquisitions. The U.S. SEC has confirmed to the CSA that short-form prospectuses prepared under this rule will qualify as a home jurisdiction document under the MJDS.

NI 44-102 *Shelf Distributions* and NI 44-103 *Post-Receipt Pricing* were also both amended effective December 30, 2005, to align with NI 44-101.[86]

NI 44-101 is a significant shift in the approach to primary market disclosure. With 3,800 issuers listed on the TSX and TSX Venture Exchange,[87] the Instrument has opened up use of short-form prospectuses from several hundred to several thousand issuers. Moreover, it has given those issuers, including a number of small- and mid-cap issuers, access to a national market on a more expeditious and cost-effective basis. It has simplified the disclosure requirements for an offering, while promoting continuous disclosure objectives in terms of investor protection.

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[86] National Instrument 44-102 – *Shelf Distributions*, amended NI 44-102 and companion policy effective Dec. 30, 2005 provide for shelf qualification for distributions qualified under certain provisions of NI 44-101, amended to align with NI 44-101 (short-form prospectus). An issuer is qualified to file a preliminary short-form prospectus that is a preliminary base shelf prospectus if, at the time of filing, the issuer is qualified under s. 2.2 of NI 44-101 to file a short-form prospectus (effective 25 months, not current AIF and does not satisfy requirements of s. 2.7(1) or (2) of NI 44-101, etc.) and is aimed at harmonizing lapse dates for receipt issued for a base shelf prospectus; and harmonize requirements for unaudited financial statements and statement audited in compliance with U.S. GAAS to align with NI 44-101. National Instrument 44-103 – *Post Receipt Pricing,* in force on Dec. 30, 2005, amended to align with NI 44-101 (short-form prospectus), amends s. 4.5(2).
[87] Wise Persons Committee, *Its Time, supra,* note 22 at 5.

Equally significant, it indicates a degree of convergence between an integrated disclosure approach and a bifurcated primary/secondary highly codified regime, as it allows issuers to rely more heavily on their continuous disclosures when bringing new securities to the market.

ii. Exemptions and Disclosure

Issues in respect of the exemptions system are being explored by another research project for this Task Force series and beyond the scope of this report. However, it is important to note that exemptions recognize that small-and medium-cap issuers may face particular cost challenges in bringing their securities to the market, and the nature of the offering may not require the same level and complexity of disclosure. Hence in order to remove impediments to raising capital and encourage entrepreneurial activity, the issuers are exempted from certain requirements. One issue is whether these exemptions have added to or exacerbated the disclosure challenges, including timeliness, cost and clarity, particularly as there is not national uniformity in exempt market requirements.[88] The provision for exemptive relief from the prospectus provisions recognizes that particular types of investors are positioned to protect themselves, given their market experience and access to information, and hence do not need the full protection of the prospectus process.

National Instrument 45-106, *Prospectus and Registration Exemptions,* was promulgated in 2005 as an instrument that harmonizes numerous prospectus and registration exemptions across Canada.[89] It is aimed at reducing the transaction costs of issuers carrying out multi-jurisdictional exempt distributions by merging the most popular exemptions into one instrument, making the exemption process more straight-forward, efficient and user-friendly. Its implementation should facilitate private placements, particularly relevant in sectors such as junior mineral exploration companies.[90] However, there is not complete

[88] Stromberg observes that the limitations on transferability that arise from the variance of exemptions from province to province presumably have a negative effect on the price at which the securities can be traded, suggesting that small issuers and retail investors are most likely to be more greatly affected, *supra*, note 5 at 297.
[89] National Instrument 45-106 – *Prospectus and Registration Exemptions* (in force, Sept. 14, 2005).
[90] NI 45-106 does not encompass all of the available exemptions; CSA staff notice 45-304 articulates the remaining local exemptions offered in each jurisdiction, illustrating that distinctions continue to exist that do not appear particularly relevant. The instrument consolidates the pre-existing exemption for a rights offering made by an issuer to purchase additional securities of such issuer. An issuer must comply with National Instrument 45-101 – *Rights Offerings*. All Canadian jurisdictions have adopted the accredited investor exemption, broadening the definition. All jurisdictions have adopted the minimum amount exemption, which exempts a person purchasing securities as principal if the acquisition cost is not less than $150,000, paid in cash at the time of the trade and the trade is in a security of a single issuer. All jurisdictions have adopted the "private issuer" exemption from Multilateral Instrument 45-103 – *Capital Raising Exemptions* ("MI 45-103"), permitting trades in a security of a "private issuer" to a person coming within specifically enumerated categories who purchases the security as principal. The

harmonization.[91] The harmonization initiative impacts disclosure as investors will have more uniform access to exemption rules, and greater information and certainty as to who does or does not have access to the exempt market.

iii. Enhancing the Integrity of the System and Creating Incentives for Ethical Behaviour by Capital Market Participants

There are different normative views in Canada and internationally as to whether a full rules-based system creates a climate of compliance or generates a "tick-the-box view" of compliance without market participants really acquiring a sense of responsibility for their disclosures.[92] A point of divergence of views is whether standards-based, less-codified requirements can better foster a climate of compliance and integrity once the issuer is known to the market and to regulators, and whether the standards-based approach instils a concern for market participants based on an enshrined sense of responsibility.

One view is that less codification equals a level of uncertainty for issuers in terms of the standards they must meet; for investors in terms of availability of a remedy for particular conduct; and for regulators in terms of resources allocation for compliance and enforcement initiatives. A different view is that less certainty can mean that issuers and their principal officers must consciously make disclosure decisions on the basis of standards and their best judgment on materiality and investor protection.

Given the high level of deference by the courts to securities regulators and the fact that the courts themselves are not experts, one question is whether less codification would really just relegate rule-making to securities administrators, as uncertain standards are enforced at the first instance by regulators,

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Instrument allows securities to be traded for mining petroleum or natural gas properties; and allows business combination and reorganization exemption harmonized and expanded to include dissolutions and winding up.

[91] For example, in all jurisdictions excepting Ontario enable certain close personal friends and business associates of a director, executive officer or control person of the issuer or an affiliate thereof to purchase the issuer's securities as principal. Ontario has adopted a distinct exemption for trades in securities to "founders" of the issuer, affiliates of founders, control persons and spouses, parents, siblings, grandparents or children of founders, directors, and executive officers. NI 45-106 largely reproduces the exemptions for trades to employees, senior officers, directors and consultants in Multilateral Instrument 45-105 – *Trades to Employees, Senior Officers, Directors and Consultants* ("MI 45-105", now revoked). The instrument consolidates the exemptions for trades in a security in connection with amalgamations, mergers, reorganizations or arrangements, dissolution and winding-up. In Québec, the *Act to amend the Securities Act and other legislative provisions* ("Bill 72") came into force on December 17, 2005. Bill 72 repeals the provisions of the *Securities Act* (Québec) regarding exemptions, replacing them with those found in NI 45-106. It also establishes a mutual reliance review procedure between Québec and the other Canadian jurisdictions.

[92] Compare for example, the approaches of the U.S. and UK to compliance.

and lack of codification could leave securities regulators as the *de facto* law-makers.[93] While there may be some risk of that outcome, one notes that securities regulators are already rule-makers at first instance, and that a standards-based approach may shift that slightly, to encouraging issuers to cultivate best disclosure practices. The principles-based or standards-based approach to disclosure does not eliminate rules; it reduces the degree of specificity in some instances so that issuers can develop disclosure practices based on their size, sector and governance structure.

It may be that in the short term, there will not be normative consensus on how to best create incentives for ethical behaviour. However, as recommendations are developed for disclosure requirements, it is important to ask the question of how the particular rule will promote a culture of compliance. Whether the approach taken by a proposed rule is principles-based or rules-based, linking the disclosure change to a specific public policy objective may help to identify whether the appropriate incentives are being offered to advance the goals of disclosure: the protection of investors, promotion of market efficiency and public confidence in markets.

Notwithstanding normative disagreement on the level of codification required, it appears that there are special cases, such as extractive industries, where there is broad recognition and support for the idea that more uniform regulated information needs to be placed in the market. NI 43-101 *Standards of Disclosure for Mineral Projects*, in force December 30, 2005, is one such example where market confidence may be higher with increased codification.[94] NI 43-101 establishes standards for all oral and written disclosure

[93] Interestingly, this may argue further for a separation of the regulatory and adjudicative functions of securities commissions in order to allow for an impartial and highly skilled second-check (with the appropriate due process requirements) on the enforcement of securities by regulators at first instance.

[94] National Instrument 43-101, *Standards of Disclosure for Mineral Projects* (in force Dec. 30, 2005) It requires the disclosure of mineral resources and mineral reserves be made in accordance with industry standard definitions approved by the Canadian Institute of Mining, Metallurgy and Petroleum unless otherwise provided by the rule; and requires certain disclosure to be supported by a written technical report prepared and certified by a qualified person, who in certain cases must be independent as defined by the rule. It revises the definition of "mineral project" to allude explicitly to "royalty interest or similar interest" in any exploration, development or production activity. Consequently, an issuer whose sole interest in a mineral project is a material royalty interest is subject to NI 43-101. There is a plain language requirement, requiring clear and unambiguous language. Primary responsibility for public disclosure remains with issuers and its directors and officers. Proper use, by or on behalf of the issuer, of technical reports and other scientific and technical information provided by the qualified person is responsibility of the issue and its directors and officers. It clarifies prohibited disclosures, e.g. results of a preliminary economic analysis that includes inferred resources. The instrument rejects a proposed blanket exemption to eligible foreign issuers; rather, the CSA will consider such relief on a case-by-case basis. The new instrument considers a qualified person independent of an issuer if there are no circumstances that could, in the opinion of a reasonable person cognizant of all relevant facts, interfere with the qualified person's judgment in preparing a technical report. It provides a broad exemption from the proviso that the qualified person compiling the technical report inspect the subject property. This exemption applies in the case of extreme weather conditions. It eliminated the requirement to file a technical report each time becomes a reporting issuer in another jurisdiction if it is already a reporting issuer in another Canadian jurisdiction and eliminated the necessity for a technical report where an offering memorandum is delivered

made by an issuer concerning mineral projects and requires that all disclosure be based on information prepared by or under the supervision of a qualified person.[95]

iv. The Interplay Between the Business Judgment Rule and Disclosure Obligations Under Securities Law

This is an area that will become increasingly significant with the introduction of civil liability. As noted above, the Ontario Court of Appeal in *Kerr* v. *Danier Leather* held that the business judgment rule applies to director decisions in the context of primary market disclosure. It held that reasonableness is the centerpiece of the business judgment rule, involving a range of reasonableness. A decision can be reasonable, not perfect, and directors can select one of several reasonable alternatives. On the facts, the Court held that the business judgment rule applied to the determination of the objective reasonableness of Danier's forecast.

In considering the relationship between disclosure requirements and the business judgment rule, it is important to distinguish between the notion of deference to business judgment and the so-called "business judgment rule" as it has been articulated in U.S. caselaw. In the U.S., the business judgment rule is a rule of "judicial non-review" of business decisions, creating a rebuttable presumption that directors are meeting their duty of care; and that in performing their duties, are honest, well-meaning and their decisions are informed and rational. The business judgment rule limits judicial review of directors' business decisions in order to limit the amount of interference in business affairs by the judiciary.[96] Hence the rule shields directors from personal liability and shields the decisions of corporate boards from judicial review. In Canada, deference to business judgments and more recently, enshrinement of the business judgment rule in corporate law is aimed at providing a defence to duly diligent directors from allegations that they have failed to meet their statutory and common law obligations to act in the best

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exclusively to accredited investors under local securities laws. It bans blanket disclaimers that either renounce liability for the portion of the report prepared by the qualified person or create limitations on the use or publication of the report that would hinder the issuer's continuous disclosure obligations.

[95] See also, National Instrument 51-101 – *Standards of Disclosure for Oil and Gas Activities* (in force 2003; amendments in force Dec. 30, 2005). Effective September 19, 2005, public oil and gas companies in British Columbia must file a Report of Management of Directors on Reserves Data and Other Information. The CSA amended NI 51-101 and the related companion policy as a result of the changes to NI 44-101. The Instrument sets requirements where disclosing reserves data; disclosure concerning prospects; estimates of fair value of an unproved property, prospect or resource; units of equivalency between oil and gas; finding and development costs. It sets requirements for material change disclosure.

[96] *Aronson* v. *Lewis,* Del. Supr., 473 A.2d 805, 812 (1984); *Sinclair Oil Corp.* v. *Levien*, Del. Supr., 280 A.2d 717, 720 (1971).

interests of the corporation.[97] There are important differences between the U.S. and Canadian tests that have not yet been fully or carefully considered by Canadian courts.

The Ontario Court of Appeal in *Kerr* v. *Danier Leather* appears to be the first instance in which a Canadian appellate court considered the interplay between statutory disclosure requirements and the business judgment rule. Arguably, it is not that helpful as a first analysis of this relationship because of the particular facts of the case, although recognition that there is judgment involved in the determination of materiality was an important finding.

Clearly there are business judgments involved in an issuer determining what is material, and what is a fact versus a change. Given that directors and officers have the greatest knowledge and understanding of their business, operations and capital, they are the most likely to be able to accurately determine what is or is not material. Disclosure decisions can involve difficult business judgments and in distinguishing between material fact and material change reporting in Canadian securities law, arguably the determination of where particular information fits within those differing obligations is a matter of business judgment. However, such business judgment bumps up against clear statutory requirements in respect of disclosure, and arguably, where the law specifies a particular disclosure, there is no business judgment to be made; the issuer must comply with the law.

The judgment issue is complicated when there are determinations as to when to disclose material facts, such as early merger discussions or transactions under negotiation, or consideration of moving into new markets or a different product line. Disclosure too early may be highly premature and have a negative effect on a proposed transaction or direction that the issuer is considering taking. It may also cause investors to make decisions prior to the particular matter having actually crystallized, which in turn could harm their interests and create uncertainty in the market.[98] While the issuer can make confidential disclosure to the regulator, this does not prevent the disclosure from entering the market; it only delays its release. Where early discussions regarding transactions or mergers do not crystallize but are disclosed on a delayed basis, this could send misinformation to the market.

However, another view is that early disclosure does not send misinformation, particularly if the disclosure is accurately couched in language that reflects the degree of uncertainty. It is the information being

[97] *Peoples Department Stores* v. *Wise* [2004] 3 S.C.R. 461.
[98] *Re YBM Magnex International Inc., supra,* note 54, para. 29.

presented as more certain than it is that creates the misinformation. If this problem were addressed, early disclosure could have an explanatory and mitigating effect on market disruption.

If deference to business judgments is too high, it will create incentives for issuers not to disclose and then seek the protection of the business judgment rule to justify business decisions not to disclose material changes. In turn, this may prevent material information from being disclosed in a timely manner and would create barriers for investors in establishing claims of breach of statutory disclosure requirements.

As a result, some express statutory language addressing this issue may be warranted, as this is an area that is likely to generate different judicial approaches to the deference question across jurisdictions, resulting in increased uncertainty for all market participants. The objective of the disclosure requirement is to ensure that the issuer deals with disclosure of good news and bad news with equal urgency. Arguably, deference to business judgment should apply only to judgments that are made on a reasonable basis after a duly diligent process. Given current information asymmetries, it may be necessary to place an onus on the issuer's officers to establish their due diligence, as has occurred in the context of takeover bid cases. Any deference given as a judicial interpretation tool or device should be carefully limited so as not to detract from both the express disclosure requirements in securities law and the goals of investor protection, market efficiency and public confidence in capital markets.

v. Multi-Jurisdictional Disclosure System

The Multi-Jurisdictional Disclosure System (MJDS) was adopted to facilitate prospectus offerings for distributions in Canada and the U.S. or distributions by U.S. issuers in Canada where they comply with U.S. requirements and the requirements of NI 71-101 *Multi-Jurisdictional Disclosure System.*[99] Similar provisions in the U.S. facilitate distributions by Canadian issuers in the U.S.. The MJDS system is significant for Canadian issuers as it provides them with cost-effective and timely access to U.S. capital markets.

Hence an important consideration for reform of primary market disclosure in Canada is whether any reforms will continue to meet MJDS and reciprocal requirements in the U.S.. A significant percentage of Canadian issuers seek capital in the U.S. market and thus, to an extent, larger structural policy choices, such as moving to an integrated disclosure model, could have significant implications for cross-border primary markets.

[99] NI 71-101 *Multi-jurisdictional Disclosure System.*, *supra,* note 10.

As will be discussed in Part 8, the U.S. is engaged in a number of very recent initiatives, including new rules that permit use of a "free-writing prospectus", where electronic access equals delivery for a prospectus. Essentially, integrated disclosure documents can be used for either primary or secondary market disclosure. This development entails a degree of convergence between primary and secondary market disclosure requirements.

These U.S. developments will need to be closely monitored and any Canadian reform initiatives will need to take account of possible market impact of diverging too much from the current reciprocity established under the MJDS. However, aligning requirements of those listing on both Canadian and U.S. exchanges should not detract from the public policy question of whether the Canadian disclosure regime should craft obligations sensitive to the needs of small- and mid-cap issuers who distribute only in Canada, while ensuring continued investor protection.

vi. Primary Disclosure Options

a) Maintain the *Status Quo*

One option in respect of primary market disclosure is to maintain the *status quo* for the next period. There has been considerable change to primary market offerings in recent years, most notably the recent change to short-form prospectuses and the move to the passport system. Arguably, market participants want some time with these new features in the market before they face another round of regulatory changes.

One difficulty with this option is that most of the changes that have recently occurred are primarily for the benefit of issuers. The relaxing of rules on initial offerings is premised on the belief that those issuers that now gain access to more expeditious and cost-effective capital are meeting disclosure standards that benefit investors. This does not address some of the information and understanding asymmetries identified earlier, and thus maintaining the *status quo* for a period may not be sufficient to fully meet the goals of investor protection.

Whether the *status quo* is maintained or other reform options adopted, resources should be directed towards assisting issuers in meeting best practices. This can involve web-based education; the dissemination of model or exemplary primary market disclosure documents; or services that assist issuers, particularly smaller issuers or those new to the market, to develop best practices in disclosure from the outset of their distributing activities.

b) Maintain the Current Disclosure Documents, but Require Delivery

A second option is to maintain the current disclosure requirements for primary market offerings, but impose a requirement that the issuer or other intermediary that is selling the securities ensure that the investor receives a copy of the prospectus and other relevant disclosure documents prior to accepting the purchase. While this is supposed to be the case currently, a number of market participants and regulators suggested that this frequently does not occur. Arguably, this poses a liability risk for the intermediary, but absent empirical evidence of the extent or seriousness of such a practice, the only policy option may be to ensure clear policy standards regarding electronic or paper delivery of the prospectus and accompanying education of intermediaries regarding their obligations to the market. A clearer requirement would place the onus on the selling party to at least ensure the information was in the hands of the investor prior to the investment decision.[100] While this would address some of the issues discussed above in respect of access to information, it does not address the issue of fragmentation of information or the challenges now posed by web-based disclosure. A variation on this option is to require a mandatory summary sheet that introduces the prospectus in plain-language form, similar to that adopted by the EU, discussed in Part 8 below.

c) Merge Prospectus Documents with Continuous Disclosure Documents

A third option is to introduce an integrated disclosure system that provides for one set of disclosure documents that are applicable to both primary and secondary markets.[101] This responds to the concern that access to a prospectus may not mean meaningful delivery of full, true and plain disclosure. This option is discussed at some length in Part 7, section vi, of this report, including the requirement of a 4-5 page summary statement in plain language that is accessible and understandable to all investors, the content of disclosure for which the issuer can be held liable. As discussed in Part 7, introduction of an integrated disclosure document would require regulators to clearly specify the scope and timing of required update of the information, particularly given the current (and perhaps sometimes artificial) distinctions between material fact and material change in primary market disclosure.

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[100] Stromberg has argued that the delivery provisions of applicable securities legislation has resulted in information not being actually delivered to people but only deemed delivered serves to protect issuers, promoters and intermediaries, but is a problem for investor protection as people cannot be considered to have understood information that has not been actually delivered; *supra*, note 5 at 306.

[101] This could be a document that is limited to material change or one that requires all material information, the level of disclosure to be a public policy choice.

7. Secondary Market Disclosure

This part examines secondary market disclosure in Canada and assesses whether the current system provides sufficient disclosure to investors of material information or constitutes overreach in terms of the requirements placed on issuers. It considers whether existing policies and instruments offer a sufficiently integrated disclosure regime for primary and secondary markets. This part also prospectively analyzes the implications of introducing into the Canadian framework a statutory civil remedy for continuous disclosure violations through the new Section XXXIII.1 of the Ontario *Securities Act.*

Secondary market disclosure requirements include a number of ongoing disclosure obligations. Issuers must issue a press release and file a material change report when a material change occurs in the business, operations or capital of the issuer and the change is likely to affect the price or value of the securities. The issuer is also obligated under securities legislation and national instruments to file interim and annual financial statements, annual information forms (AIFs), and management's discussion and analysis of financial condition and results of operations (MD&As). The issuer must circulate proxy information circulars that accompany mandatory solicitation of proxies, with specified information aimed at providing security-holders with disclosure that allows them to exercise their default control rights in an informed manner. There are also secondary market disclosure requirements for a series of special situations, such as filing insider trading reports, changes to insider holdings,[102] take-over bid circulars and issuer-bid circulars in specified circumstances, early warning reports and self-dealing disclosure. These ongoing disclosure obligations are aimed at providing the market with timely information, in order to promote the express goals of securities legislation.

Many of the same issues regarding reduction of information asymmetries, costs of production, dissemination of information, and transaction costs of enforcing compliance that were discussed above in respect of primary markets, also apply to secondary markets. Given that there have been a number of incremental developments in recent years, such as MD&As now being required as part of the continuous disclosure regime, or AIFs a product of securities policy, the fragmentation of information in secondary market disclosure needs to be carefully assessed and improved.

[102] The ownership of securities by controlling shareholders, directors and officers and other insiders.

i. Different Standard and Quality

There have been some initiatives towards national harmonization. For example, NI 51-102 *Continuous Disclosure Obligations* harmonizes continuous disclosure obligations.[103] Another example is NI 81-106 *Investment Fund Continuous Disclosure Obligations*, aimed at harmonizing continuous disclosure obligations for investment funds;[104] and NI 71-102 *Continuous Disclosure Obligations and Other Exemptions Relating to Foreign Issuers*.[105] However, different secondary market standards nationally, which continue to exist, raise issues regarding the integrity of the system and may create disincentives for ethical behaviour by capital market participants. They also may increase risks for investors in terms of uncertain and unequal access to market information.

National Instrument 51-102 *Continuous Disclosure Obligations* came into force on March 30, 2004; however, its concomitant obligations became directly applicable in 2005. It harmonizes the continuous disclosure requirements imposed on reporting issuers in Canada. It significantly altered the content of the issuer's disclosure in the MD&A. Notable changes include: a new duty to update forward-looking information in prior MD&A; an obligation to provide in the yearly MD&A selected annual financial information for each of the three most recently completed financial years; disclosure of defaults in bank covenants; disclosure in tabular form of contractual obligations due over the next five years; disclosure of off-balance sheet arrangements potentially impacting operations or financial condition; analysis of critical accounting estimates; and disclosure of information about outstanding equity and voting shares.

NI 51-102 requires reporting issuers other than venture issuers to file their annual financial statements and annual information forms on or before the ninetieth day after the end of the most recently completed

[103] National Instrument 51-102 – *Continuous Disclosure Obligations*; (adopted March 2004).
[104] NI 81-106 *Investment Fund Continuous Disclosure Obligations* (in force on June 1, 2005). It aims to harmonize continuous disclosure obligations for investment funds, prescribing the type and content of financial statements, and creating consistent requirements for all types of investment funds. NI 81-106 requires all investment funds that are reporting issuers to prepare, file and mail to registered and beneficial owners of securities, annual and interim management reports of fund performance. Other continuous disclosure obligations relate to material changes and annual information forms. Prior to NI 81-106, funds that were reporting issuers but not mutual finds in distribution were not required to file an annual information form if they fell below a certain size. The instrument also imposes requirements on investment funds that are reporting issuers in respect of proxy solicitation and information circular requirements, changes to auditors, voting results at security-holder meetings, and the filing of material contracts.
[105] National Instrument 71-102 – *Continuous Disclosure Obligations and Other Exemptions Relating to Foreign Issuers*; CSA Staff Notice 51-316. NI 71-102 came into effect on March 30, 2004 and is aimed at creating an interface of Canadian securities compliance requirements with those already complied with by foreign reporting issuers. For instance, the material change reporting requirements of NI 51-102 do not apply to SEC foreign issuers and designated foreign issuers, as defined in NI 71-102, provided they comply with the requirements of NI 71-102.

financial year.[106] For the first time, reporting issuers must file on SEDAR copies of the following documents or amendments to documents: articles of incorporation; current bylaws; security-holder or voting trust agreements that can reasonably be regarded as material to an investor; shareholders' rights plans; any other contract of the reporting issuer that can reasonably be regarded as materially affecting security-holders' rights or obligations generally; and any contract entered into, other than in the ordinary course of business, that is material to the issuer and that was entered into within the last financial year, or before the last financial year but is still in effect. Additional ongoing filings requirements include: any disclosure material that the reporting issuer sends to its security-holders; a report of voting results following a meeting of security-holders at which a matter was submitted to a vote; and any news release issued by the reporting issuer that discloses information regarding historical or prospective results of operations or financial condition for a financial year or interim period.[107]

This harmonization is an important step forward for the disclosure regime, as it creates consistency in disclosure across jurisdictions and enhances the level of certainty for market participants in terms of the type and scope of available disclosure. Yet it has not addressed the problems highlighted earlier in terms of access and comprehensiveness of the materials filed on SEDAR.

Had the B.C continuous market access model been proclaimed in force, it would have eliminated the need for material change reports in that jurisdiction as continuous disclosure records would contain all material information all the time through press releases. Even here, however, there may have been a fragmentation of information issue in terms of where the information would be located.

It is important in terms of providing timely and accessible disclosure that the periodic financial statements and material change reports are located in the same place, particularly if the system is to move to greater electronic disclosure. An option, canvassed in Section vi. below, is the creation of a single living document of continuous disclosure, aimed at addressing the fragmentation problems, but retaining the current framework of disclosure requirements under NI 51-102.

The CSA published a request for comments in December 2005 on streamlining of NI 51-102 to further harmonize continuous disclosure obligations, to replace most local continuous disclosure requirements and provide exemptions for certain foreign issuers aimed at reducing issuer costs and streamlining some

[106] An issuer with a December 31 year-end had to commence complying with these new filing deadlines as of March 2005.
[107] There is an interface provision such that an issuer will be in compliance with B.C proposed continuous disclosure requirements if it complies with NI 51-102, in the event that the B.C legislation comes into force.

requirements.[108] Issuers may have concerns about potential transaction costs associated with further change to the regulatory requirements after so little experience with NI 51-102 in the market, and after having geared up to meet the requirements. However, further streamlining could enhance cost-effectiveness of disclosure. Moreover, the notice may provide the Task Force with an opportune moment to consider a more highly integrated continuous disclosure regime, aimed at reducing fragmentation and increasing accessibility.

ii. Disclosure as a Signalling Device

Securities regulators have clearly entered the market for corporate governance, driven largely by a "comply-or-explain" approach. Disclosure has a corporate governance role in that it is a signalling device for directors, investors and other market participants. It can provide insights into operational efficiency, director oversight and managerial skills, as well as the board's capacity to respond to upside and downside risks and adjust business plans. The extent of regulatory intervention may impact the effectiveness of disclosure as a signalling device.

Here, as in other aspects of disclosure, until recently there was some serious divergence of views among securities regulators as to the extent of codification required in respect of governance disclosure. Some jurisdictions, most notably Ontario, wanted certification and reporting that mirrored the *Sarbanes Oxley Act* section 404 requirements *("S-Ox* 404"*)*, discussed in Part 8 below. B.C objected to officer and auditor certification, but under its new legislation, would require issuers to disclose corporate governance information on structures, processes and practices.

The CSA had developed Multilateral Instrument 52-111 *Reporting on Internal Control over Financial Reporting*, which securities regulators in every Canadian jurisdiction except B.C had published for comment in February 2005. Proposed MI 52-111 was substantially similar to the requirements of the *S-Ox* 404 Rules. The BCSC sought comments on its own approach to internal control reporting.[109]

Under Proposed MI 52-111, management of an issuer would have been required to evaluate the effectiveness of the issuer's internal control over financial reporting, as at the end of the issuer's financial year, against a suitable control framework. The issuer would have been required to file a report of management on its assessment of the effectiveness of the issuer's internal control over financial reporting,

[108] CSA Request for Comments, December 9, 2005 (2005) 28 OSCB 9845.
[109] BCN 2005/08 BCSC.

including a statement as to whether the internal control over financial reporting is effective, and a report of the issuer's auditor prepared in accordance with the CICA's auditing standard for internal control audit engagements.[110]

After considerable public discussion, and in light of developments in the U.S. that appear to have backed off of some certification requirements under *S-Ox* 404, on March 10, 2006, the CSA reported that it was not going to proceed with MI 52-111.[111] Instead, the CSA proposes to expand MI 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings.* MI 52-109 currently requires certification of internal control over financial reporting, beginning with financial years ending on or after June 30, 2006.[112]

The proposed enhancement of MI 52-109 will require issuers to include some internal control reporting requirements; specifically, the CEO and CFO of a reporting issuer, or persons performing similar functions, will be required to certify in their annual certificates that they have evaluated the effectiveness of the issuer's internal control over financial reporting as of the end of the financial year. They will also be required to certify that, based on their evaluation, they have caused the issuer to disclose in its annual MD&A their conclusions about the effectiveness of internal control over financial reporting as of the end of the financial year. Issuers will be required to disclose a description of the process for evaluating the effectiveness of the issuer's internal control over financial reporting and the conclusions about the effectiveness of internal control over financial reporting. The board of directors and its audit committee, in consultation with management, can choose to engage the issuer's auditor to assist in discharging their respective responsibilities, but engagement of the auditor will not be a requirement under MI 52-109.[113] The proposed requirements will apply in respect of financial years ending on or after December 31, 2007, allowing issuers time for implementation.

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[110] *Ibid.*

[111] BCSC: 52-313 Status of Proposed Multilateral Instrument 52-111 Reporting on Internal Control over Financial Reporting and Proposed Amended and Restated Multilateral Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings [CSA]52-313, Status of Proposed Multilateral Instrument 52-111 Reporting on Internal Control over Financial Reporting and Proposed Amended and Restated Multilateral Instrument 52-109 [CSA], effective March 10, 2006.

[112] MI 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings.*

[113] The CSA expressly noted that "the proposed internal control reporting requirements do not diminish the existing obligations of the issuer's auditor under generally accepted auditing standards to (i) understand the issuer's internal controls relevant to the audit of the issuer's financial statements and (ii) read materials with which the auditor is deemed to be associated, such as the issuer's MD&A, assess whether they are inconsistent with their knowledge and take appropriate action if they are aware of any material misstatements of fact or, if applicable, misrepresentations", *ibid.* at 3.

The express objectives of the proposed internal control reporting requirements are to improve the quality, reliability and transparency of financial reporting, and increase management's focus on, and accountability for, the quality of internal control over financial reporting, regardless of size or listing.[114]

The type of disclosure proposed is helpful in meeting the goals of securities law. However, it is important to consider how these developments fold into the challenge of full, true and plain disclosure discussed earlier in this report.

While the reporting of financial controls is one aspect of governance disclosure as a signalling device, it also highlights that there is some convergence in regulatory approach. The CSA announcement not to proceed with MI 52-111 will allow for closer alignment of the approaches of regulators across Canada. The March 2006 announcement may signal a period in which governance disclosure will become harmonized. More importantly, eliminating a serious point of difference between Canadian regulators on the amount of codification of governance disclosure required may kick-start once again national discussion regarding the modernization and nationalization of securities law.

iii. Continuous Market Disclosure as a Regulatory Tool

An important role of securities law is to govern the capital-raising process, with the basic assumption being that an efficient capital-raising process for business enterprises is essential to a healthy economy.[115] Investors need confidence in the ability of securities markets to act as intermediary between investors and business enterprises. The continuous disclosure regime is a regulatory tool that encourages an efficient capital-raising process while providing a level of comfort to prospective investors that the issuer's securities are a sound place to invest.[116] About 94% of all capital market activity in Canada is in secondary markets.[117]

Regulators and stock exchanges use disclosure compliance as a means of monitoring issuers. They have an ongoing concern as to whether financial statements provide the information they are supposed to provide, information that will allow investors to weigh the risks and benefits and to make informed choices about investing in the issuer. Revamped and refined continuous disclosure requirements in recent years have also been used as an instrument to respond to the problems of shaken investor confidence

[114] *Ibid.* at 4.
[115] Condon, Anand and Sarra, *supra*, note 6 at 2.
[116] For a full discussion, see *ibid.*
[117] CSA Notice 53-302, *supra,* note 30.

created by the corporate failures in the U.S.. Initiatives towards uniformity and transparency of issuer reporting enhance the confidence of market participants, and also assist regulators in determining where to direct their enforcement activities. A key aspect of using disclosure as a regulatory tool is the ability to ensure reciprocal enforcement of judgments for disclosure violations.

In 2002, the CSA announced a shift in focus in terms of monitoring disclosure, and the Ontario Securities Commission and other regulators began devoting more resources to continuous market disclosure monitoring.[118] An issuer's continuous disclosure record allows regulators to make informed choices under risk assessment policies as to where to direct their monitoring and enforcement resources most effectively in the market.

a) Deficient Disclosure Warnings

One example of how disclosure is used as a regulatory tool is the recent CSA staff notice regarding *Continuous Disclosure Review of Small Issuers,* issued to alert issuers of common deficiencies encountered by the CSA in reviewing smaller issuers' continuous disclosure record.[119] This included the most common financial statement deficiencies arising from failure to comply with GAAP, including interim financial statements, related-party transactions, cash flow statements, enterprises in the development stage, revenue recognition and new GAAP requirements; deficiencies in MD&A in reporting operational analysis, liquidity and capital resources, projects under development and related-party transactions; common non-technical disclosure deficiencies made by those in the extractive industries; SEDI filing requirements; timely disclosure in terms of maintaining ongoing communication with the capital markets; mandatory role of the audit committee and its involvement with corporate disclosure; and CEO and CFO certification.[120] The deficiencies in disclosure serve as a signalling device by securities regulators as to where issuers are failing to comply and may be vulnerable to sanction.

However, this deficient disclosure warning notice also raises the question of whether current codification is too onerous for smaller issuers, and hence their recurring deficiencies under the continuous disclosure regime.

[118] OSC Staff Notice 51-708 *Continuous Disclosure Review Program Report*, (2002) 25 OSCB 5555.
[119] CSA Staff Notice 51-316 *Continuous Disclosure Review of Small Issuers* (published December 9, 2005).
[120] *Ibid.*

b) Issuer Education

In addition to investor and intermediary education, discussed in Part 5,, there should be enhanced education of issuers so that they can meet their continuous disclosure obligations. Currently, securities regulators disagree on their role in this respect. One view is that the role of the commissions is to regulate and that issuers then have the responsibility to meet disclosure requirements. The difficulty with this approach is that given the myriad of disclosure requirements promulgated in recent years, issuers, even those with the best objectives, can be uncertain as to whether they are meeting the expectations set out in the requirements. The response has been in some instances, “consult your legal counsel”. Yet, while legal counsel are important participants in the securities law regime, their focus is more likely to be on meeting the liability threshold in interpreting regulatory requirements, instead of discerning best practices. There is some shift, however, by regulators in this view regarding education. The OSC recently issued information on how small issuers can meet their continuous disclosure obligations.[121] Written in plain language, it provides a guide to how to devise best practices. Some regulators have also developed an investor education web-page.

One rationale for the reluctance of regulators to assist with education of issuers is a concern that issuers may later rely on what the commission advised during a subsequent regulatory enforcement proceeding. There are two responses to this. First, any difficulty in this respect would be addressed by bifurcation of the regulator and first-instance enforcement functions of the Commission from its adjudicative function. Other administrative agencies operate this way - the Ontario Workers’ Compensation Board to name one. Under such a structure, the front-line policy maker can assist market participants with education. On any appeal, policies of the Commission or first stage rulings help inform the tribunal’s deliberation, but are not binding on the tribunal, which interprets the statutory language and regulations after the benefit of a fair hearing with appropriate weighing of the evidence. Binding rulings on particular issues are then incorporated into the Commission’s further educative and first-instance enforcement initiatives, creating overall enhanced certainty in meeting the regulatory requirements.

The other option is to provide funding for academic and professional institutions to provide cost-effective and accessible issuer education. While the TSX and other groups currently perform some of this role, much more education is required, along with sharing best practices or model examples of disclosure. Web-based delivery of such public education could be highly effective.

[121] *Ibid.* Interestingly, while the notice appears to be one of advising small issuers of deficiencies, the OSC views it as a user-friendly educational document. Arguably, it could be taken either way.

The vast majority of issuers want to comply with disclosure requirements. Disclosure regulation is aimed at a level of transparency and consistency in the market. While it also provides the standard against which to hold "bad actors" accountable, the regulatory system needs to recognize those issuers who wish to comply and need some assistance in understanding constantly changing rules.

iv. Secondary Market Civil Liability Regime

Arguably, the availability of a civil liability regime for secondary market disclosure enhances the public policy objective of investor protection, as it creates civil remedies for misrepresentation. It provides another tool in investor protection because it allows individuals, individually or through approval of class actions, to hold the issuer and its directors and officers accountable for their failure to meet statutory disclosure requirements.

While this report does not examine enforcement and liability, it is important to briefly mention Ontario's new civil liability as having the potential for creating incentives to enhance investor protection in respect of disclosure.[122] There is some debate about the effects of a civil liability regime, and whether such remedies ought to serve as a deterrent or solely as a compensatory scheme, however, this debate is beyond the scope of this report. At the time this report was submitted to the Task Force, the B.C government enacted new legislative amendments regarding civil liability, and time did not permit a careful analysis of the provisions as they relate to disclosure reform.

Part XXIII.1 of the *Securities Act* (Ontario) came into force on December 31, 2005. Part XXIII.1 imposes liability for documents filed as part of an issuer's disclosure, such as press releases, financial statements and MD&As. A plaintiff need not prove reliance on the misrepresentation in forming an investment decision, addressing the potential hurdle of proving actual reliance that could hinder the initiation of class actions in Ontario for misrepresentations in continuous disclosure. The extent and limits of liability vary in the case of an issuer, a director or officer, expert or an influential person, a defined term. There are also procedural protections to deter frivolous actions.[123]

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[122] What is not addressed in this report are a number of policy questions in respect of civil remedies, such as whether directors and officers should be personally liable for misrepresentation or whether the issuers should indemnify them in particular (or all) circumstances.
[123] One sub-issue is whether the language is sufficient to protect from strike suits.

Ontario's provisions cover public issuers that are not reporting issuers in Ontario but who have a real and substantial connection to the province. Part XXIII.1 creates a right of action for misrepresentations in public oral statements relating to the issuer's business or affairs made by those with actual, implied or apparent authority to speak on the issuer's behalf.[124]

Part XXIII.1 of the *OSA* imposes liability for oral statements made by a person with apparent authority; however, if the statement-maker lacked "actual or implied" authority, only the statement-maker is liable. The issuer is not liable. Ontario's legislation differentiates between misrepresentations in "core" documents and "non-core" documents or public oral statements. While Part XXIII.1 obliges issuers to disclose material changes, the originally proposed B.C civil liability provisions mandated disclosure of material information.[125]

Under Part XXIII.1, the plaintiff must prove that such defendant knew of the change and its material nature. The plaintiff must establish that either the defendant knowingly evaded knowledge of the change or its material nature, or the defendant was guilty of gross misconduct in failing to make timely disclosure.[126] Part XXIII.1 articulates a list of considerations in ascertaining an investigation's reasonableness, including the existence and nature of any system designed to ensure compliance with continuous disclosure obligations and the reasonableness of dependence on that system. The new provisions cover future-oriented financial information, but offer a different kind of test than for civil liability under primary market disclosure.

The existence of the civil liability provisions is likely to create incentives for issuers to be duly diligent in their disclosure decisions. How the courts interpret these provisions in conjunction with both statutory obligations and deference to business judgments will be critical in determining the effectiveness of the remedy and its incentive effects on disclosure behaviour. In terms of reform of disclosure, an important consideration for the Ontario provisions is the different scope and standards of liability imposed for primary and secondary market disclosure.[127]

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[124] The 2004 B.C legislation creates a right of action for oral statements, if general disclosure of the statement was reasonably foreseeable, and if the person had express or implied authority to represent the issuer.

[125] Plaintiffs in Ontario arguably confront a higher burden of proof than their B.C counterparts when bringing an action for failure to make timely disclosure against defendants other than the issuer, the issuer's officers, investment fund managers and officers of an investment fund manager

[126] Under the 2004 B.C provisions, an issuer can defend a claim by showing use of a reasonable system to ensure legislative compliance.

[127] The B.C legislation, had it been proclaimed in force, creates consistency in its approach to liability for disclosure violations in primary and secondary markets.

a) The Role of Business Judgment in Secondary Market Disclosure

As with primary market disclosure, there are difficult judgments to be made on whether information is material such that it may be disclosed to the market. The TSX has offered guidance to its issuers, distinguishing events that affect all market participants from those that affect the issuer or a select number of issuers.[128]

In part, the difficulty stems from making the determination of what is a material fact and what is a material change, as discussed earlier. However, since issuers on the TSX must disclose to a material information standard, this is not problematic. Rather, the question is at what point transactions, particularly early-stage negotiations, are sufficiently crystallized that they must be disclosed.

v. Disclosure Prohibitions on Persons in a Special Relationship

A third component of the Canadian disclosure system is the limits placed on persons deemed to be in a special relationship with the issuer. These persons are prohibited from communicating an undisclosed material fact or material change except in the necessary course of business and they are prohibited from trading in securities of the issuer while the material change or fact is generally undisclosed.[129] Persons that acquire information in the necessary course of business are then considered to be in a "special relationship" with the issuer to the extent that they are prohibited from trading the securities or disclosing the information before the material fact or material change is generally disclosed. The objective is to ensure that information acquired by the insider but not yet available to investors, is not used to gain an unfair market advantage, a form of self-dealing. The introduction of tipping prohibitions in Canada prevents selective disclosure;[130] however, one question is whether it also provides an excuse to disclose less information to the market.

vi. Policy Options for Secondary Market Disclosure

Any initiatives to modernize the disclosure regime should build in mechanisms that test for effectiveness in terms of whether outcomes of a proposed rule-change are clear and likely. The BCSC has observed

[128] TSX, Company Manual.
[129] See for example, ss. 1(1), 76(5), Ontario *Securities Act*.
[130] National Policy 51-201 *Disclosure Standards and Rescission of NP 40- Timely Disclosure.* For the U.S. equivalent, see, *Selective Disclosure and Insider Trading,* SEC Release No. 33-7881, 34-43154, IC-24599, File No. S7-31-99.

that rules should also be tested for their neutrality, in terms of not favouring particular types of market participants; for their flexibility, in that it should require market participants to exercise judgment and place responsibility on officers to establish and apply adequate systems and controls to meet regulatory requirements; for their scope, in that rules should prescribe only what is necessary to achieve the intended outcome; and clarity in terms of rules that are accessible, understandable and able to be applied practically. These indicia - neutrality, flexibility, scope, clarity and the ability to assess effectiveness - are important to consider as any reform initiative moves forward.

a) Maintain the S*tatus Quo* for a Period

See the discussion above regarding primary market disclosure and the rationale for gaining some experience with current requirements prior to further disclosure reform. Issuers have concerns about the transaction costs of continual rule-change and the resultant need to retool internal controls and disclosure reporting practices. Moreover, securities regulators have an educative rule to play in terms of assisting issuers in understanding the existing rules and encouraging compliance. As with primary market disclosure, however, retaining the *status quo* does not address the information asymmetries and accessibility issues discussed earlier in this report.

b) Maintain the Current Disclosure Documents but Create a Requirement for Centrally Locating Them

This option focuses on reform of SEDAR in terms of creating access to existing disclosure documents. It could require the introduction of a "one-click full access" system as discussed under technological developments above. Alternatively, the onus could be placed on issuers to have all disclosures posted on their website. As note above, there are cost implications to such a choice; however, the majority of issuers already provide this service.

c) An Integrated Market Disclosure Document (IMDD)

One option for continuous disclosure is to create one new uniform document for both primary and secondary market disclosure, which would then be updated on an ongoing basis with material change filing. The integrated market disclosure document (IMDD) would combine financial statements, MD&A, AIFs and proxy circulars into one document. There could be three mandatory parts to the document and one optional part.

Part A of the new IMDD would be an executive summary of no more than four to five pages, which would provide true and plain disclosure of all material information. It would provide specific references to relevant materials in the remainder of the document, but would in itself be required to meet the threshold of reporting material information such that investors could both rely on the information and seek remedies where the issuer failed to disclose or flag material information in Part A. The executive summary would not provide "full disclosure", as that is what the remainder of the document would provide; however, it would be fulsome in that it would flag the material information.

Part A of the proposed IMDD is modeled after the EU requirement that a prospectus must include a summary that conveys, in a brief manner and in non-technical language, the essential characteristics and risks associated with the issuer, any guarantor and the securities, as discussed in Part 8, section ii below. The EU summary must contain a warning that it should be read as an introduction to the prospectus, and that any decision to invest should be made on the basis of the prospectus as a whole. Similar wording could be adopted as a caution that investors are to make any investment decisions based on the IMDD as a whole. The EU directive also specifies that no civil liability shall attach to any person solely on the basis of the summary, including any translation thereof, unless "it is misleading, inaccurate or inconsistent when read together with other parts of the prospectus". It would be important to articulate what the potential scope and limits of liability are in Part A of the IMDD, given that a summary could not provide full disclosure. The EU language would appear to provide the appropriate limits to liability and could be adopted.

Part B of the IMDD would contain the financial statements and information that is currently disclosed in the AIF, providing the substantive body of disclosure. While an effort would be made towards plain-language disclosure, Part B would provide a level of detail that would allow analysts and other market participants the full breadth of information required to make an informed assessment of the issuer. Part B would reduce overlap between the financial statements and the AIF, and provide an integrated snapshot of the issuer's capital, business and operations.

Part C of the proposed IMDD would contain MD&A type descriptions by senior officers, but would be directly referenced to Part B and hence eliminate duplicative information. Moreover, the statutory requirements could specify a standard for this type of analysis, enshrining either a subjective/objective standard or an objective standard on which to measure the quality of disclosure. Whatever standard is set, it should be clear to all market participants.[131]

It may also be timely to require disclosures in Part C of the IMDD in respect of corporate social and environmental responsibility measures, as part of the corporate governance disclosures. The U.K. is a leader in encouraging such reporting, but corporate social responsibility disclosures are also increasingly prevalent in EU and other countries. Canada's requirements in this respect are minimal at best, although a number of issuers, particularly in the resource sector, are routinely disclosing social and environmental sustainability measures. This corporate social and environmental responsibility disclosure could be pegged to a standard developed by private actors, such as a comply-or-explain standard pegged to the principles of the Global Compact, or it could merely impose a general requirement to disclose practices in respect of the issuer's social and environmental responsibility practices.

Part D of the IMDD would comprise Future Oriented Financial Information (FOFI), separated because of the particular nature of forecast disclosure. While FOFI would be optional, as it is under the current regime, it too would have clear standards, whether based on a reasonableness standard or reasonable investigation standard.

Subsequent material change reporting would then be integrated directly into the IMDD, with notice of material change referenced directly to sections of the IMDD. Both the electronic version of the IMDD on the issuer's website and the IMDD filed with SEDAR would then be updated to contain the material information, integrating all information into one document, but flagging the date of the change in disclosure. Press releases and the revised IMDD with the material change incorporated would clearly signal to market participants at the front of the document the nature of the change and its location in the document. The IMDD as a whole would be a living disclosure document, and material change reporting would include electronic tags specifying when the particular change was integrated into the document. The Part A summary would also flag material information or changes and electronic tags could direct the reader to the appropriate part of the IMDD document for further detail and/or analysis.

The IMDD could be held to a standard of disclosure of all material information, thus aligning it with the current TSX disclosure standards. The uniformity in requirements would promote harmonization of standards and certainty for issuers. A less rigorous option is that the IMDD would hold the issuer to a standard of disclosure of material information at the time the IMDD is first presented to the market, with

[131] There is currently some uncertainty in the market regarding the standard to be applied, because judgments such as *Peoples Department Stores (supra,* note 98) and *Kerr* v. *Danier Leather (supra,* note 65), which did not address secondary market liability, have sent mixed signals to directors and officers as to the scope of their obligations.

material changes integrated on an ongoing basis, and then requiring a semi-annual update to include all material information, with the Part A summary clearly specifying the last update period. Micro- and small-cap issuers could be required to undertake the update annually if there are concerns about the costs of semi-annual compliance for these issuers. This latter option may be the less costly alternative for issuers. However, arguably, given that the TSX requires a material information standard already, there is only a relatively small portion of the market that is still working on a standard that distinguishes between material fact and material change in reporting requirements.

This notion of a dynamic current and accessible document is possible given technological developments. Instead of investors having to access numerous documents, plus trying to ascertain whether there have been material change reports, all information publicly available to the market would be contained in one document at all times, including a "last updated" reference. This model would place the emphasis on disclosure to meet the principal goals of informing and protecting investors, while generating efficiencies in capital markets. The transaction costs of converting to a single document would eventually be offset by the streamlined nature of the disclosure.

However, even this proposal, which in some respects is the optimal option for investors, is not without risks. One would have to address the issues raised earlier regarding integrity of the documents at a "point in time" of disclosures, and the custodial responsibility. The cost consequences of asking issuers to bear the responsibility of keeping an IMDD up to date on their website would also have to be considered.

The proposed IMDD does meet a number of the indicia of effective rule changes. It would be flexible, in terms of issuers creating an IMDD that allows the issuer to meet a standard of disclosure. It would eliminate duplication in primary and secondary market disclosures. It would provide all market participants with single portal access to current material information about the issuer. It could be designed with the TSX and other exchanges so that issuers are required to meet only one set of disclosure standards, whether the activity is in the primary or secondary market.

In terms of whether there would be a role for underwriting in the IMDD, this is a public policy choice. There could be a requirement that a new IMDD that is available to the investing public for the first time be accompanied by an underwriting assurance/certification or an issuer certification that the IMDD constitutes "all information that to the best of the underwriter's or issuer's knowledge and belief is necessary for the investor, as a reasonable person acting reasonably, to make an informed investment decision". Presumably, issuers and underwriters would continue to be held to different standards based on their access to, and control of, information. While the reasonableness standard would still have to be interpreted by the courts in order to provide some certainty to parties in their level of disclosure responsibility, it would shift the disclosure system to an investor-based, as opposed to a market-effects based standard, aligning securities regulation with the standard currently applied by the TSX to 85% of capital market activity in Canada.

Another option is that these assurances could be contained in the statute, instead of the IMDD, which would clearly set out a statutory basis for holding those making the disclosure or providing the assurances liable for the disclosures based on this standard. Arguably, however, specifying the reasonableness standard on the IMDD itself would provide retail investors with information as to the standard of disclosure. One option would be to enshrine the reasonableness standard in the statute, specifying that the issuer and/or underwriter "must be assured, before offering or recommending the securities, that the IMDD contains information, that to the best of the issuer's or underwriter's knowledge and belief, is necessary for the investor, as a reasonable person acting reasonably, to make an informed investment decision" and then have a reference to the statutory provision containing this disclosure standard as part of the standard format introducing the IMDD and its scope and contents.

Even if one were not to require underwriting assurances or certificates, there is likely to be a continued market for underwriters in securities offerings. Presumably, the role of the underwriter would continue where there is a bought-deal arrangement, as the underwriter would be representing its confidence in the disclosures by the nature of its arrangement with the issuer. However, there is also likely to be a market for underwriters where the issuer is unknown or relatively unknown to the market, or where the nature of the securities offered are novel or not well-known, and hence the use of underwriter's assurances boosts the issuer's ability to sell the securities in a primary offering.

Finally, the IMDD should address the plain language issue, particularly in the Part A summary. Here, in addition to definitions of full, plain and true disclosure discussed earlier in this report, the U.K. standard may provide guidance: essential information must be "written in such a way that gives a co-operative, motivated person a good chance of understanding the document at first reading and in the same sense that the writer meant it to be understood", as discussed in Part 8, section iii, below. This standard of easily understandable, but comprehensive, disclosure may provide the appropriate balance between accessibility and comprehensiveness of disclosure. Such a standard could be integrated into the statute, in order to provide certainty for issuers, some regulatory persuasive power for regulators, and to instil a more uniform culture of plain-language compliance.

8. Comparative Disclosure

i. Introduction

This part undertakes comparative analysis of recent developments in primary and secondary market disclosure requirements in other jurisdictions, examining selected issues that were identified in Parts 4 to 7 of this report as important concerns or challenges for the Canadian disclosure regime. Disclosure features of five jurisdictions are examined: the European Union (EU), the United States (U.S.), Australia, Japan and China, this latter as illustrative of an emerging capital market.[132] Where disclosure differences within the EU are of note, the United Kingdom (U.K.) is examined as a Member State.

The first feature that influences disclosure is that in all the jurisdictions examined, regulatory oversight is concentrated largely in the hands of a national regulator; for example, the Japan Financial Supervisory Agency (FSA) and the China Securities Regulatory Commission (CSRC).[133] In fact, most of the European Union Directives specify that a single administrative authority must be competent to ensure that securities provisions are adopted, ensuring continued concentration of regulatory oversight within the Member States.[134] Concentration of regulatory oversight with a national regulator is extremely significant for disclosure, as these jurisdictions are not struggling with the question of harmonization of disclosure and its enforcement within their securities law regime. Hence the transaction costs that arise in Canada from trying to negotiate consensus on disclosure are not apparent, and many of these jurisdictions are then able to focus more directly on first principles of disclosure and how their systems might be reformed to meet those principles.

Second, disclosure has been adopted as the principal means of protecting investors and creating incentives for behaviour in all the systems studied. All jurisdictions were disclosure-based, rather than merit-based, regulatory systems. The purpose of disclosure is to provide timely, accurate and complete information to the market, so that investors can make informed investment decisions based on timely and relevant information. Most jurisdictions studied are examining reforms designed to advance the accessibility of disclosed information to investors, although there are a range of approaches to this issue.

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[132] As noted in the introduction, the Report does not measure efficiency in systems: that task is being undertaken by another investigative study for this Task Force.

[133] The CSRC is responsible for supervision and regulation of national securities and futures markets, information disclosure in securities issuance and trading, licensing and supervising intermediaries and strengthening supervision of disclosure of information, inspection and enforcement initiatives

[134] See for example, *Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on Insider Dealing and Market Manipulation* (Market Abuse Directive), OJ L 096, 12.4.2003, 0016-0025 at Article 11.

In another parallel to the Canadian system, disclosure is also a key policy instrument in terms of serving as a transaction cost control device, a regulatory tool and a governance-signalling device. As in Canada, disclosure in the studied jurisdictions is aimed at reducing the cost of access to capital, serves as a measure of compliance with regulatory requirements and can communicate messages to capital market participants in respect of the effectiveness of corporate governance of the issuer.

A third feature of the comparative study is that there has been increasing harmonization of requirements for market disclosure, most notably, with harmonization efforts in the EU. This is harmonization across country boundaries, plus harmonization within economic unions. One example is the recent EC Directive on the *Harmonization of Transparency Requirements in Relation to Information about Issuers whose Securities are Admitted to Trading on a Regulated Market*.[135] Increasingly, frameworks that facilitate harmonization are being created, aimed at completing a single market for financial services. An example is the European Parliament's 2002 endorsement of a four-level regulatory framework for its Member States.[136]

Fourth, there are distinct measures for primary offering and secondary market disclosure requirements. None of the jurisdictions have adopted a continuous market access type of model, although some are moving to align primary and secondary market disclosure, and hence, arguably are moving closer to integrated disclosure. Disclosure of financial controls has become a key feature of the disclosure regimes in recent years. Given the economic importance of U.S. law in global markets, there has also been consideration in most of the jurisdictions examined as to the extent to which the jurisdiction requires increased codification of disclosure requirements in order to gain or maintain access to U.S. capital markets.

[135] 32004L0109, *Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2—4 on the Harmonization of Transparency Requirements in Relation to Information about Issuers whose Securities are Admitted to Trading on a Regulated Market and amending directive 2001/34/EC*, Official Journal L 390, 31/12/2004, p. 0038-0057 (the Transparency Directive).

[136] *Implementing the Framework for Financial Markets: Action* Plan, 11 May 1999 EC Communication; *Barcelona European Council,* March 2002. The Committee of Wise Men, chaired by Baron Alexandre Lamfalussy, made a series of recommendation regarding the system for legislating securities law, which resulted in adoption of the new regulatory framework and including establishing the European Securities Committee (ESC), which has a regulatory function; and the CESR, which has an advisory function, both formally established in 2001. Level 1 Directive-broad framework (essential) principles; Level 2 is the technical implementing measures to be adopted by the Commission, necessary to meet the objectives of the directives. Level 3 measures are intended to ensure common and uniform implementation by use of common interpretive guidance and standards agreed upon amongst regulators in CESR, hence involves co-operation amongst national securities regulators. Level 4 measures relate to enforcement of the legislation; www.cesr-eu.org.

Another common feature is the growing overlap in corporate and securities law in terms of governance disclosures. Most jurisdictions examined have adopted or are considering adoption of a "comply-or-explain" regime.

Hence overall, in terms of comparative disclosure requirements, different jurisdictions are taking different routes, but are seeking to arrive at the same destination in terms of the goals of the disclosure regime in securities law. All jurisdictions examined use disclosure as the means of regulating the securities market, to remedy information asymmetry, maintain credible capital markets and avoid imposing costs unnecessarily. However, the means diverge, in terms of rules versus standards, i.e. "tell them what to do" or "tell them to do the right thing". It is also evident that the continuous market access model and similar approaches are untested, at least in the jurisdictions examined for this study.[137] While claims for efficient delivery of disclosure could be tested empirically, to date, that would only be possible in a very thin market of small-cap issuers.

For purposes of this report, four comparative features of the jurisdictions were selected for examination: recent developments in disclosure requirements in the primary market; moves to plain language disclosure; the issue of increased codification in secondary market disclosure; and the governance role of disclosure in the examined jurisdictions. The table below sets out a summary of recent developments in these areas, breaking the four comparative features into a further subset of eight aspects of disclosure reform that may be significant in determining reform of the Canadian regime, including: a summary of plain language initiatives; integrated market initiatives; the implementation of electronic access; and materiality requirements.[138]

[137] In fact, we were unable to find any jurisdiction that has a continuous market access model.
[138] Where U.S. and other comparative disclosure is subject to comprehensive treatment by other research papers for the Task Force, the discussion is somewhat abbreviated here.

Summary comparative chart on selected disclosure issues

Jurisdiction	European Union	United Kingdom	United States	Australia	Japan	China
Primary market recent disclosure developments	Passport system; *Prospectus Directive, 2005* Option of single prospectus or 3 documents to allow fast tracking. All information that allows informed assessment of financial condition and prospects		Securities Offering Reform Rules, 2005: WKSI use of automatic shelf registration, can be used for primary or secondary offering; Free writing prospectus	Information Memorandum can replace PDS (prospectus) in some circumstances Outcomes-focused *Good Principles for PDS Disclosure*	Highly codified, recent changes adding increased codification	Highly codified requirements; does not appear to be any move yet towards a fast-tracking disclosure model.
Plain Language Initiatives	Yes Prospectus info to be easily analyzable and comprehensible Summary statement in prospectus in non-technical language stating essential characteristics, risks. No model document.	Yes Proposed rules and guidance for clear, fair and not misleading communication. Plain language so that good chance of understanding at first reading. No model plain language document	Yes Plain Language Disclosure Releases; clear, concise, understandable, short sentences, everyday words, active voice. Specified list to avoid. No model plain language document	Yes Information in PDS presented in a clear, concise and effective manner, with prohibition on deceptive or misleading statements. Plain, simple and clear No model plain lang. document	Not really, Recent requirements that prospectus must be easy for ordinary investor to understand.	No
Integrated disclosure document	No Required summary statement, but must rely on prospectus disclosures as a whole	No	No	Partial	No	No
Continuous market access	No	No	No	No	No	No
Secondary market recent disclosure developments	*Transparency Directive,* harmonizes disclosure; requires true and fair view of financial situation. *Market Abuse Directive* specifies insider, other disclosures	Examining moving to a more principles-based disclosure regulatory structure; not as codified as EU directives.	Higher degree of codification with *Sarbanes-Oxley* ad subsequent rules.	Moving toward principles-based regulatory approach, simplifying rules and burden of compliance while aimed at increasing quality and timing of disclosure	2003, more interim disclosure; swift accurate and fair. Mandatory corporate information handling officer and for foreign issuers, attorney-in-fact responsible for CD obligations	Highly codified, with specified list of continuous disclosure requirements.
Materiality Requirement	Yes; prospectus is investor test and material information; *Market Abuse Directive* has mixed reasonable investor/market impact test.	Yes Disclosure of price sensitive information on a timely basis.	Yes, common law, material test codified in *S-Ox.* Fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available	Yes, Material effect – if the information would be likely to influence persons who commonly invest in securities in deciding to buy and sell	Yes, any information expected to materially affect the price of issuer's stocks; includes codified list of material information.	Yes, must disclose any material event that may affect stock price, includes specified list. Must disclose in timely fashion all information that may have material effect on investor decision
Technological developments	Can disclose electronically, investor must be able to download and print; can request paper	Can disclose electronically under specified conditions; investor right to request paper	Move to electronic access equals delivery	Required electronic disclosure of issuer information	Can disclose electronically and shareholder digital voting	Mandatory web-based primary and secondary market disclosure.
Governance disclosure as a signalling device	Yes Comply or explain Mandatory governance reporting, eff. 2005 reduced burden on SMEs; not adopt *S-OX* 404 model	Yes Comply or explain; some mandatory reqs. Dir obligation proposals controversial. Turnbull Guidance sups, S-OX based	Yes Mandatory requirements; Rethinking of *S-Ox* 404 requirements for micro and small cap companies.	Yes Comply or explain model. Not adopt *S-Ox* 404 model	Yes Recent require disclosure of governance structures that ensure accountability for disclosures and governance practice	Yes Detailed requirements re governance disclosure, with comply or explain provisions on committees and governance structure.

ii. Recent Developments in Disclosure Requirements in the Primary Market

This part briefly examines the five jurisdictions in terms of developments in primary market disclosure requirements. It commences with the EU because although the EU framework involves a number of countries, its recent regulatory initiatives in respect of primary market disclosure most clearly mirror some of the passport initiatives in Canada.

a) European Union: Primary Market Disclosure Developments

In the EU, the most significant recent development for primary market disclosure is the move in 2005 to a full passport system for prospectus offerings.

There has been increasing harmonization of requirements for prospectuses throughout the European Economic Area (EEA), which is comprised of all EU member states plus Norway, Iceland and Liechtenstein. The EU *Prospectus Directive*, which had a full implementation deadline of July 2005, has as its purpose the harmonization of requirements for drawing up, approval and distribution of prospectuses when securities are to be offered to the public or an issuer admitted to trading on a regulated market situated or operating within an EU Member State.[139] The Directive creates a pan-European definition of "offer to the public", and is aimed at the harmonization of principal conditions for offering securities and for admission to trading.[140] It moves the EU from a mutual recognition system to a passport system. Once a prospectus is approved in one EEA country, it can be used to issue in any other EEA country.[141] It also sets out types of offerings and/or issuers that are exempt from the prospectus requirements.[142]

The *Prospectus Directive* implements the concept of Home Member State, whereby an issuer is locked into the Member State where it first makes its application to trade on the regulated market. Harmonization of the principal disclosure standards are in line with IOSCO standards.[143] The Directive allows for choice

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[139] *Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC* OJ L 345, 31.12.2003, 0064-0089, ("EU *Prospectus Directive*") at Article 1(1).
[140] EU *Prospectus Directive*, *ibid.; Commission Regulation (EC) No. 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information in prospectuses*, OJ L 149/1 EN, 30.4.2004.
[141] *Ibid.* at Article 13.
[142] *Ibid.* at Article 3.
[143] International Organization of Securities Commissions (IOSCO), *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities*, October 2002,

of a single document, or separate documents (registration document, securities note and summary note), thereby allowing for future fast-track shelf offerings.

The *Prospectus Directive* includes a number of principles that the Commission should respect in exercising its implementing powers under the Directive, including: the need to ensure confidence in financial markets among small investors and SMEs by promoting high standards of transparency; disclosure tailored to the range of investment opportunities; consistent enforcement of rules; the importance of reducing cost of, and increasing access to, capital; the need to balance, on a long term basis, the costs and benefits to market participants of any implementing measures; foster international competitiveness of the EU's financial markets; and the need to respect domestic differences where they do not unduly impinge on the coherence of a single market.[144] Hence the goals of disclosure reform parallel those articulated by Canadian securities regulators.

The Directive specifies that the prospectus is to contain all information that is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuers and any guarantor, and specify the rights attaching to such securities; the information is to be presented in an easily analyzable and comprehensible form.[145] Where an offer is made in one or more Member States excluding the home Member State, the issuer has the option of publishing the prospectus either in a language accepted by the regulatory authority of those Member States or in a language customary in the sphere of international finance.[146] The host Member State can require that a summary be translated into its official language(s).[147] An offering in the home Member State must be in the language accepted by that State and in a language customary in the sphere of international finance.[148]

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http://www.iosco.org/library/pubdocs/pdf/IOSCOPD132.pdf.

[144] EU *Prospectus Directive, supra*, note 140 at para. 41.

[145] *Ibid.* at Article 5(1); the information is to be according to the particular nature of the issuer and of the securities offered to the public or admitted to trading on a regulated market.

[146] *Ibid.* at Article 19.

[147] *Ibid.*

[148] Where an offer is made in one or more Member States including the home Member State, the issuer has the option of publishing the prospectus either in a language accepted by the regulatory authority of those Member States or in a language customary in the sphere of international finance, *ibid.* There are exemptions for securities valued at more than EUR 50.000 per unit, where the issuer has a choice of language, *ibid.* at Article 19(4).

Summary Sheets

The prospectus must include a summary that conveys in a brief manner and in non-technical language the "essential characteristics and risks associated with the issuer, any guarantor and the securities".[149] The summary must also contain a warning that it should be read as an introduction to the prospectus, and that any decision to invest should be made on the basis of the prospectus as a whole.[150] The summary is to be written in non-technical language and should not normally be greater than 2500 words.[151] Article 6 specifies that Member States are to ensure that no civil liability shall attach to any person solely on the basis of the summary, including any translation thereof, unless "it is misleading, inaccurate or inconsistent when read together with other parts of the prospectus". Where a summary must be supplemented, it is the issuer's choice as to whether the existing summary is updated or a new summary issued, but if updated, the issuer is to ensure that investors can easily identify the changes by way of footnotes.[152]

Minimum Standards

The Directive specifies that a typology of minimum information is to be established - depending on the type of issuer and securities involved - based on the information items required in the IOSCO disclosure standards for cross-border offering and initial listings.[153] There are specific schedules of required information, depending on the type of security offered in the prospectus, and the *Prospectus Directive* sets out the minimum information that is to be included in a base prospectus and its related final terms.[154] A base prospectus can be used for admission to trading on a particular market for specified types of securities.[155] The Directive includes the concept of "building blocks", which means a list of additional information requirements, not included in the schedules, to be added as the case may be, depending on the type of instrument and/or transaction for which a prospectus or base prospectus is drawn up.[156]

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[149] EU *Prospectus Directive, ibid.* at Article 5(2).
[150] *Ibid.* There is no requirement to provide a summary where the securities relate to non-equity securities having a denomination of EUR 50.000, except when requested by a Member State.
[151] *Ibid.* at para. 21.
[152] *Commission Regulation (EC) No. 809/2004* at Article 25.
[153] *Ibid.* at para. 2; EU *Prospectus Directive, supra,* note 140 at para. 22 and Article 7. International Association of Securities Commissions, *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers,* Part I, September 28.
[154] Commission *Regulation (EC) No. 809/2004* at Articles 4, 22. In the event of omission of information, includes the right to withdraw acceptances in specified circumstances; *ibid.* at Article 8.
[155] *Ibid.* at Article 5(4). A base prospectus means a prospectus containing all relevant information as specified in Articles 5, 7 and 16; EU *Prospectus Directive*, at Article 2(r).
[156] *Ibid.* at Article 2(2).

An issuer can have one prospectus document or three documents comprised of a registration document, a securities note and a summary note.[157] The use of several documents is aimed at allowing fast-tracking of some securities to the market.[158] The registration document must contain the information relating to the issuer. The securities note is to contain the information concerning the securities offered to the public or to be admitted to trading on a regulated market. The securities note must contain information that would normally be provided in the registration document if there has been "a material change or recent development that could affect investors' assessments since the latest updated registration document or any supplement".[159] Hence, material change reporting in this instance is an investor test. The Annexes of the *Prospectus Directive* list contents required in the summary, registration document and securities note.

Where the prospectus is composed of separate documents, care is to be taken to avoid duplication of information.[160] The final terms of a prospectus can be in either a separate document or by inclusion into the base prospectus, and the issuer must specify in a clear and prominent statement where full information on the issuer is set out.[161] There are also a number of other documents that may be incorporated into the prospectus or base prospectus by reference, with the issuer clearly specifying any material changes in information. The issuer must endeavour not to endanger investor protection in terms of comprehensibility and accessibility of the information.[162]

As in Canada, there is voluntary disclosure of financial forecasts. Where the issuer does present forecasts in a share registration document, it is to be presented in a consistent and comparable manner, in a manner not to be confused with disclosure of known trends or other factual data with material impact on the issuer's prospects.[163] Issuers are to provide an explanation of any changes in disclosure policy relating to FOFI when supplementing a prospectus or drafting a new prospectus.[164]

The *Prospectus Directive* also recognizes that wholesale investors should be able to make investment decisions on "other elements than those taken into consideration by retail investors"; thus it specifies a

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[157] EU *Prospectus Directive, supra*, note 140 at Articles 5(3) and 12.
[158] *Ibid.* at para. 23.
[159] *Ibid.* at Article 12(2), the securities and summary notes are subject to separate approval.
[160] Commission *Regulation (EC) No. 809/2004* at para. 4; "to this end, separate detailed schedules for the registration document and for the securities note, adapted to the particular type of issuer and the securities concerned, should be laid down in order to cover each type of security", *ibid*.
[161] *Ibid.* at Chapter 3, Article 25(5). There can be some duplication of information included in a base prospectus where final terms are in a separate document in specified circumstances, *ibid.*
[162] *Ibid.* at Chapter 4, Article 28.
[163] *Ibid.* at para. 8.
[164] *Ibid.*

differentiated content of prospectus for debt and derivative securities that is aimed at those investors purchasing a debt or derivative securities with a denomination per unit of at least EUR 50.000.[165] The regulatory authority of Member States can also impose additional disclosure requirements because of the particular nature of activities of the issuer.[166]

Materiality

Any new matter liable to influence the assessment of investment, arising after publication of the prospectus but before the closing of the offer or start of trading on a regulated market, requires the approval and dissemination of a supplement to the prospectus.[167] Hence the disclosure requirements during a prospectus offering are more rigorous than in Canada, as no distinction is made between material fact and material change in the disclosure obligations. The EU regulation imposes an investor test of materiality. Article 16 of the Directive specifies when supplements to the prospectus are required, specifically, “every significant new factor, material mistake or inaccuracy relating to the information included in the prospectus which is capable of affecting the assessment of the securities” must be included, if it arises between the time the prospectus is approved and the final closing of the offer to the public.[168] Investors who have already agreed to purchase or subscribe for the securities before the supplement is published have the right within two working days to withdraw their acceptances.[169]

Commission Regulation (EC) No. 809/2004 sets out the format of the prospectus to comply with the *Prospectus Directive.* It specifies that a prospectus is to be composed of the following parts: a table of contents, a summary, and the risk factors linked to the issuer and the securities.[170] “Risk factors” is defined as a list of risks that “are specific to the situation of the issuer and/or the securities and which are material for taking investment decisions”.[171]

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[165] *Ibid.* at para. 14.
[166] *Ibid.* at para. 22.
[167] EU *Prospectus Directive, supra*, note 140 at para. 34.
[168] *Ibid.* at Article 16.
[169] *Ibid.* at Article 16(2).
[170] *Commission Regulation (EC) No. 809/2004. supra,* note 153 at Article 25.
[171] *Commission Regulation (EC) No. 809/2004. supra,* note 153 at Article 2(3).

Electronic Disclosure

The Directive allows for electronic communication of information.[172] Issuers are to ensure that where a prospectus is published in electronic form, safety measures are to be used to maintain the integrity of the information, to avoid manipulation or modification from unauthorized persons, and to avoid altering its comprehensibility.[173] The prospectus must be easily accessible when entering the website; it must not be able to be modified; it shall not contain hyperlinks, with the exception of links to the electronic addresses where information incorporated by reference is available; and the investor must be able to download and print the prospectus.[174] The prospectus must be available and delivered free of charge to investors in paper form when requested.[175] There are also specified requirements for publication of notice.[176]

The prohibition on most hyperlinks is an interesting regulatory choice, particularly when other jurisdictions are exploring allowing the use of hyperlinks to amplify disclosure information. See the discussion earlier in this report regarding the risks and benefits of allowing such disclosure.

The *Prospectus Directive* specifies that issuers are subject to ongoing disclosure obligations, but are not required to publish updated information regularly, but most issuers are to list, at least annually, all relevant information published or made available to the public over the preceding 12-month period.[177]

The *Prospectus Directive* specifies that regulatory authorities of host Member States can recognize issuers incorporated in third countries, provided that the prospectus has been drawn up in accordance with international standards, including IOSCO standards, and where the financial and other information requirements are equivalent to requirements under the Directive.[178]

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[172] The prospectus is deemed available when published in newspapers, in printed form available to the public, or in an electronic form on the issuer's website and , if applicable, the website of the financial intermediaries placing or selling the securities, or in electronic form on the website of a regulated market where the admission to trading is sought, or in electronic form on the website of the competent authority of the home Member States if it offers this service; EU *Prospectus Directive, supra*, note 140 at Article 14.
[173] *Ibid.* at para. 31 and Chapter V, Article 29.
[174] *Ibid.* at Chapter V, Article 29. If the prospectus is made available on the websites of issuers and financial intermediaries or of regulated markets, these are to take measures to avoid targeting residents of Member States or third countries where the offer of securities does not take place, such as assertion of a disclaimer as to who are the addresses of the offer, *ibid.* at Article 29(2).
[175] EU *Prospectus Directive, supra*, note 140 at para. 31 and Article 14(7).
[176] *Commission Regulation (EC) No. 809/2004. supra,* note 153 at Chapter V, Articles 31-33.
[177] *Ibid.* at para. 27. EU *Prospectus Directive, supra*, note 140 at Article 10.
[178] EU *Prospectus Directive, supra*, note 140 at Article 20.

Précis

In summary, although the difference between the EU and Canada is clearly that the former is dealing with multiple sovereign states, the EU's express goal is a fully integrated financial market; and some of the historical challenges in terms of different standards, costs of capital and investor access to information are the same challenges faced in the Canadian system. Hence, the EU passport initiative in primary markets is an important model for thinking about harmonization across jurisdictions. It sets uniform first principles, but allows some local adaptation where those local rules do not infringe the overall objectives or required standards of primary market disclosure. At least in respect of the primary market, the EU Directives do appear to be having some convergence effect on standards.

While the EU has moved to a full passport system, there is no evident move towards an integrated disclosure system for primary and secondary offerings, and so this does not assist in Canada's consideration of integrated disclosure as a possible option. The EU initiatives offer the option of multiple primary market disclosure documents to fast-track offerings, and do not expressly address the fragmentation of information issues identified in respect of the Canadian system. Similarly, an issuer has an option of revising the summary statement or creating a new one, which could lead to problems of investor access and fragmentation of information

While the required plain-language summary statement to EU prospectuses is an important initiative, the EU has clearly determined that the summary must contain a warning that it should be read as an introduction to the prospectus, and that any decision to invest should be made on the basis of the prospectus as a whole. Hence it does not assist in thinking about whether a summary statement could be used as a more comprehensive basis on which to found accountability or liability. It does, however, allow us to consider whether the liability line has been drawn in the appropriate place for such summaries; specifically, that a summary sheet to a prospectus will not attract liability unless it is misleading, inaccurate or inconsistent when read together with other parts of the prospectus. The EU *Prospectus Directive* does impose certainty across the EEA in that regulators do not have the option of opting out of the liability protections afforded to issuers completing the summary of prospectuses, fostering the efficient markets goal of securities regulation.

The EU initiative also allows differentiated content for primary market disclosure, based on the type of securities and expected market for those securities. Finally, it is of note that the EU has adopted an investor test, not a market impact test, as the standard for measuring material primary market disclosure.

b) United States: Recent Primary Disclosure Developments

The new U.S. Securities Offering Reform Rules, effective December 2005, focus on enhancing disclosure by encouraging communications related to registered securities offerings; timely delivery of information to investors without mandating unnecessary delays in offering process; and improving the registration and other procedures in the offering and capital formation process.

The Securities Offering Reform Rules create a new class of "well-known seasoned issuers" (WKSIs) comprised of issuers that are presumed to be the most widely followed in the marketplace.[179] WKSIs can use a new "automatic shelf registration" process, which allows them to register unspecified amounts of specified types or classes of securities on immediately effective registration statements, without allocating between primary and secondary offerings, and can exclude more information from the base prospectus. It eliminates the delivery requirement for final prospectuses.

The shelf registration rules for WKSIs allow more flexibility and faster issuing. It loosens "quiet period" rules that govern what the issuer can say before and during offering. Communications by issuers more than 30 days before filing a registration statement will be permitted without violating the "gun-jumping" provisions, as long as they do not refer to an offering that is the subject of a registration statement. For prospectus delivery, access equals delivery, hence electronic access is sufficient. The rules permit use of a “free-writing prospectus”. Currently, MJDS issuers are not eligible to be WKSIs, although those that meet the financial requirements could become eligible if they voluntarily file an annual report on SEC Form 20-F.

To satisfy the U.S. materiality standard in disclosure obligations, there must be a substantial likelihood that a fact “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available”.[180] This is a common law, as opposed to statutory, test of materiality. Hence, while the U.S. was engaged in a period of increased codification for primary market disclosure requirements, the recent Securities Offering Reform Rules suggest that the pendulum is swinging back in part. As in Canada, the U.S. is now distinguishing between those issuers well known to the market and those that are new, in terms of the extent of additional disclosures required to bring a new issue to the market. The Canadian Securities Administrators (CSA) is monitoring the U.S. primary market developments and looking at further relaxing of its own short-form prospectus rules, based on the

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[179] Securities Offering Reform, SEC Release No. 33-8591 (19 July 2005) 70 FR 44722.
[180] For a discussion, see Condon, Anand and Sarra, *supra*, note 6 at 269-270.

U.S. changes. While there is no evidence yet in the U.S. of a conscious move towards an integrated-disclosure regime, the automatic shelf registration process and free-writing prospectus essentially move the U.S. system towards more integrated primary and secondary market disclosure.

The U.S. SEC is also engaged in considering whether to devise a proportional disclosure regime for micro- and small-cap issuers. In March 2006, the SEC released its exposure draft of the Final Report of the SEC Advisory Committee on Smaller Public Companies.[181] It proposes establishment of a new system of scaled and proportional securities regulation for smaller companies. Among other proposals, it recommends adopting a disclosure system that integrates with disclosure rules that apply to WKSIs, but based on capitalization.[182] The premise is that micro- and small-cap companies account for 78.5% of all U.S. public companies, but represent only 6% of total market capitalization, and that the offering requirements, as well as *S-Ox* 404 requirements create a disproportionate burden on smaller issues in meeting compliance.[183] What is proposed is a system of governance reporting that allows smaller issuers exemptive relief from some of the most stringent requirements under *Sarbanes-Oxley* and subsequent rules.

Interestingly, definitions of micro-cap and small-cap differ considerably in the U.S.. The SEC report defines micro-cap as less than $128.2 million capitalization and small-cap at $128.2-$787.1 million capitalization. Given the size of Canadian issuers, any further changes to relieve companies of *S-Ox* 404 requirements will likely scoop in a sizeable number of Canadian-based cross-listed issuers.

In summary, the move by the U.S. to more integration of primary and secondary market disclosure requirements may signal that it is timely for Canada to consider a similar move. While it is important to align our capital markets, it is equally important to be sensitive to the business culture, size and specific needs of Canadian market participants.

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[181] SEC, Exposure Draft of the Final Report of the SEC Advisory Committee on Smaller Public Companies, SEC Release Nos. 33-8666; 34-53386, (3 March 2006). The SEC Advisory Committee was established in 2004, SEC Press Release No. 2004174.

[182] The current definition of WKSI is companies with a public float of $700 million or more, as opposed to a specified capitalization.

[183] SEC, Exposure Draft, *supra,* note 182 at 5.

c) Australia: Recent Primary Disclosure Developments

The Australian regulatory system is currently responding to a large growth in retail investing.[184] The Australian Securities and Investment Commission (ASIC) has developed outcome-focused *Good Disclosure Principles* for Product Disclosure Statements (PDS). This is part of a series of initiatives to simplify reporting and reduce the burden of primary market disclosure compliance. An information memorandum in compliance with ASX rules can be sufficient in some circumstances instead of a PDS; and must be sent to all security-holders. The requirement is for information in the memorandum or PDS to be presented in a clear, concise and effective manner, with prohibitions on misleading or deceptive conduct or statements.

Australia has also implemented a directed disclosure approach: a specified list of items plus any information that might influence a decision to invest. The onus is with the issuer, and the ASIC will not pre-vet a PDS unless exceptional circumstances exist. PDSs for managed investment products that state or imply that the product is able to be traded on a financial market must be lodged with ASIC prior to release to consumers.

Amendments now require investment firms in their PDS to include descriptions of the "extent to which labour standards or environmental, social or ethical considerations are taken into account" in the selection, retention or realization of the investment. Initiatives are aimed at simplifying the reporting regime and reducing burden of compliance on reporting companies, while enhancing quality and timeliness of information provided to the market.

Regulators' concerns about disclosure under a PDS may lead to notification of concerns or an interim stop order, based on whether the PDS is misleading or deceptive; contains all relevant information; meets content requirements; is worded in a clear, concise and effective manner; considers changes that now make the PDS deficient; adherence to industry standards; and the circumstances surrounding its preparation in terms of the extent to which ASIC *Good Disclosure Principles* have been followed.

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[184] 55% of Australian adults own shares directly or indirectly through mutual funds or superannuation funds; 44% own shares directly. ASIC, *Corporate Wrongdoing: ASIC's Enforcement Role*, (2 December 2005) at 3.

There are two types of relief from disclosure requirements: disclosure-based relief and exemption-based relief.[185] Disclosed-based relief is available where retail clients have, through some alternative means, the benefit of disclosure that is comparable to that which might otherwise be contained in a prospectus or Product Disclosure Statement (PDS).[186]

Closing a Gap

Differences in regulatory requirements between wholesale and retail markets raised the potential for financial products issued in the wholesale market to be on-sold to retail investors within 12 months, creating potential for abuse in terms of bypassing primary market disclosure requirements. The *Financial Services Reform Act 2001* (FSRA) came into effect March 11, 2002, amending, among other things, the provisions that regulate securities' disclosures.[187] The on-sale provisions were aimed at minimizing the opportunity for issuers of securities or other financial products to avoid giving disclosure to retail investors by first issuing the financial product to an intermediary for whom disclosure is not required, who then would on-sell the product to retail investors.[188] Given that on-sell practices concerned secondary market transactions, they did not attract the obligation to issue a PDS, because disclosure requirements under the *Act* generally applied to issue of securities, not their resale, unless the sale occurred within 12 months of the issue and the on-sale provisions apply.[189]

The new provisions were aimed at ensuring that retail investors receive adequate disclosure for what was essentially the issue of securities and that the issuer is liable to retail clients for the efficacy of the disclosure. Notice verifies that the issuer has complied with its disclosure obligations and has provided the market with disclosure that is equivalent to that ordinarily available under a prospectus or PDS.[190]

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[185] The disclosure relief is based on equivalencies; ensuring retail investors have the information ordinarily available. The exemption-based relief is an enumerated list of categories that are exempted from the on-sale provisions, including employee share schemes, share purchase plans, options, etc. *Ibid.* at 8.
[186] ASIC, *[PS173] Disclosure for on-sale of securities and other financial products* (December 2004).
[187] *Financial Services Reform Act 2001* (FSRA), March 11, 2002, Sections 707(3) and (4).
[188] *Ibid.* at 4.
[189] Prospectus disclosure under Pt 6D.2 and PDS disclosure under Pt 7.9; *ibid.* at 5.
[190] Ss. 708A and 1012DA operate as exemptions from on-sale provisions, issuers must provide notice to the market that the issuer has provided a full release of information to the market under s.708A(5) or s. 1012DA(5), or provide a prospectus or PDS for a retail issue that is more or less contemporaneous with an institutional placement under s.708(11) or 1012DA(11), *ibid.* at 8.

Failed Primary Market Disclosure

The ASIC will enforce prospectus disclosure requirements. For example, the ASIC initiated proceedings against Fincorp in 2005, alleging that its 2004 prospectus was misleading and omitted information required by the *Corporations Act*. In a judicially approved settlement order, Fincorp consented to a declaration that the prospectus did not adequately disclose information regarding the security, and the issuer was to offer certain investors all of their money back, up to $20 million to approximately 1,000 investors.[191]

The current prospectus regime, introduced in 1991, gave investors remedies in respect of loss incurred due to directors and advisors who negligently or dishonestly caused the loss. However, the Deputy Chair of the Australian Securities and Investments Commission observed in December 2005 that there appear to have been no successful judgments awarding damages for a defective prospectus, although there have been a few settlements.[192]

Hence Australia is facing a number of the same issues in respect of disclosure as Canada. It is reforming primary market disclosure to facilitate more rapid access to the market for issuers, but at the same time is struggling with how to make disclosures clear and accessible for the entire range of investors in the market. Its move to use of the information memoranda and PDS, with an issuer-responsibility regulatory approach, is likely to increase timeliness and reduce costs to market. However, its own regulators note the difficulties in enforcing either regulatory or civil remedies. It will be important to track developments in Australia, in terms of the efficacy of some of the recent policy options chosen.

d) Japan: Recent Primary Disclosure Developments

The regulation of securities in Japan is shared between the Japanese Financial Services Agency (FSA), which oversees securities markets and administers primary securities regulation and anti-fraud measures; and the Securities and Exchange Surveillance Commission (SESC), which investigates and monitors the financial industry. The SESC does not have any rule-making or enforcement powers under the Japan *Securities Exchange Act*. This lack of power has been referred to as one of the greatest defects of Japanese securities regulation.[193] While historically, the regulatory system relied heavily on cultural

[191] ASIC, *Corporate Wrongdoing: ASIC's Enforcement Role*, (2 December 2005) at 7. The ASIC have also been quite aggressive in closing down illegal investment schemes.
[192] ASIC, *Corporate Wrongdoing, supra*, note 192 at 15.
[193] http://www.jftc.go.jp/e-page/index.html. Even the Japanese Fair trade Commission has these powers.

norms to enforce the integrity of the system, the growth of global capital markets and resultant increase in diversity and cultural norms of market participants in Japan has meant that this lacuna in rule-making and enforcement power is in need of reform.

The current *Securities Exchange Act* is to be replaced by the new *Securities and Exchange Act,* likely to come into force in late spring 2006. Effective April 2006, the revised *Securities and Exchange Law* specifies that if a securities registration statement contains a false statement in any of the major elements, a new fine will be applicable.[194]

In Japan, applications to become listed issuers must include extensive disclosures, including financial statements, the business plan, corporate management system, and internal controls on audits and performance.[195]

Prospectus disclosure requirements in Japan are highly codified and are aimed primarily at investor protection. The prospectus is used in tandem with the registration statement, and must meet certain disclosure update requirements if the prospectus is issued more than nine months after the effective date of the registration statement.[196] The SESC can enhance disclosure requirements or can prevent or suspend the use of a prospectus if it has reason to believe that the prospectus contains any untrue statement of a material fact or omits to state any material fact necessary to make the information not misleading in light of the circumstances under which the prospectus is used or is to be used.[197]

Disclosure requirements in Japan have historically been focused on disclosure to institutional and professional investors, and hence, regulators did not address the highly technical nature and content of primary market disclosure.[198] In recent years, public and private institutions in Japan have been encouraging individual investors to participate in the market directly and through mutual funds. As a consequence, the FSA has moved to address some of the needs of retail investors. The FSA requires that prospectuses be easy for ordinary investors to understand, however, it does not extend this requirement to directly regulating the content of prospectuses.

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194 TSE: Re-Definition of False Statements within the listing rules; December 12, 2005, http://www.tse.or.jp/english/guide/b_report/0502.html .
195 TSE Application Checklist, www.tse.org at 45-47.
196 Japan *Securities and Exchange Law*, No. 25, 1948, at Section 10.
197 *Ibid.*
198 Susumu Miyazaki, "Should Japan Adopt a Plain-Language Rule?" Minnesota Journal of Global Trade Vol. 13, No. 1, at 1-34, www.law.umn.edu/GlobalTrade.

Amendments to the Japan *Securities Exchange* Act in 2004 created new disclosure requirements for investment trusts. Matters to be disclosed in the prospectus are categorized into (1) information that has a very material effect on investors' decisions, and (2) information that has a material effect on investors' decisions.[199] The *Securities Exchange Act* requires issuers to distribute category 1 information to all the investors, "the prospectus to be distributed without demand" (*kofu-mokuromisho*);[200] and requires the issuer to present category 2 information on demand of individual investors and/or subscribers; "prospectus to be presented on demand" (*seikyu-mokuromisho*).[201] The scope of securities on which such prospectuses can be used are indicated by the Cabinet Order on the *Securities Exchange Act*.[202] According to the Cabinet Order, the designated securities are interest securities of investments trusts and foreign investment trusts, investment securities, investment corporations' debts, foreign investment securities.[203] Shares, etc., are not permitted to be distributed by such two tier prospectus system, because both (1) and (2) standards are equally important for investment decisions.[204]

Foreign-listed issuers are required to have a sponsoring exchange member that has a thorough knowledge of listing procedures and policies and is a firm that handles the public offering of securities (referred to as a securities firm).[205] This securities firm is almost always a large investment banking firm that has several functions, including brokerage, investment banking and underwriting services.[206] A foreign issuer must contact a securities firm that is a member of Tokyo Stock Exchange (TSE) for a consultation before it can apply to go public on the TSE. The corporation can choose the securities firm as an underwriter of its depository receipt on the IPO in Japan.[207] In this sense, the sponsoring exchange member does not strictly mean an underwriter, as in Canada.

Foreign-listed companies must also, at the time they seek to be listed, appoint an "attorney-in-fact" residing in Japan, who will fulfill the continuous disclosure requirements on behalf of the issuer.[208] In

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199 Amendment of *Securities Exchange Act* was enacted in June of 2004, and came into force in December 2004. However the system is only for investment trusts, not for shares.
200 *Securities Exchange Act,* section 15, ss. 2, section 13 ss. 2 , item 1.
201 *Securities Exchange Act,* section 15 ss. 3, section 13, ss. 2, item 2.
202 *Securities Exchange Act,* section 15 ss. 3.
203 Cabinet Order on *Securities Exchange Act* sec. 3-3.
204 Katsuro Kanzaki, Masashi Shitani & Yasuhiro Kawaguchi, *Securities Law*, (Serin-shoin; 2006) at 226-227.
205 Tokyo Stock Exchange, *Listing Guide for Foreign Companies* (Tokyo: TSE, March 2005). The foreign issuer must undergo a listing examination by the TSE in accordance with its rules and regulations, similar to North American processes.
206 Large firms usually have considerable authority. For the definitions of securities businesses, see Japan *Securities Exchange Act,* section 2, subsection 8.
207 Http://www.tse.or.jp/english/cash/listingguide/index.html.
208 *Ibid.* at 3; *Ministerial Disclosure Ordinance*, Article 7; TSE Rules on Timely Disclosure of Corporate Information by Issuers of Listed Securities, http://www.tse.or.jp/english/listing.

principle, the attorney-in-fact is to be selected from officers or employees of the applicant company, but the issuer may designate an attorney or other person approved by the TSE to serve as attorney-in-fact.[209] The requirements to apply for listing include a highly codified set of disclosures, which can now be submitted in English in order to ease listing application procedures for foreign companies.[210] The exception is for particular documents that the TSE designates must still be submitted in Japanese. Application documents must include a letter of recommendation by the sponsoring securities firm serving as lead underwriter and a statement of legal opinion written by a legal professional certifying that matters pertaining to laws or regulations stated in the application documents are truthful and accurate.[211] There are a number of listing disclosure criteria, including amount of shares, market capitalization, financial statements and audit reports. For privatized companies, there are additional disclosure requirements in terms of non-numerical criteria that provide disclosures regarding business continuity and profitability, soundness of corporate management and adequacy of corporate disclosure, given that this information has not previously been in the public domain.[212]

Given the very different framework of Japanese securities law, there are not currently many lessons to be drawn from Japan's primary market disclosure regime. One interesting development is the two-tiered prospectus disclosure requirement in terms of materiality, (very material versus material effects on investors' decision) in terms of particular types of securities. Japan is in the midst of further reform aimed at attracting greater amounts of international capital. Initiatives such as revised language requirements and using market participants to vet new entrants to the Japanese market are likely to facilitate that initiative. Japan does face the challenge of adjusting its own cultural and economic norms in order to be competitive in global markets, while at the same time retaining those elements of the system that it considers valuable. This is a challenge similar to that faced in Canada as it tries to move its system to a globally competitive one while ensuring continued protection of uniquely Canadian interests.

e) China: Recent Primary Disclosure Developments

China's disclosure requirements are located in a myriad of regulatory statutes and rules, not all of which are available in English, creating an issue in respect of completeness of the research included here. The *Collection of Laws and Regulations of Securities and Futures of the People's Republic of China*, compiled by the China Securities Regulatory Commission (CSRC) in 2002, is comprised of 71

[209] Tokyo Stock Exchange, *Listing Guide for Foreign Companies, ibid.* at 4.
[210] *Ibid.* at 5.
[211] *Ibid.*
[212] *Ibid.* at 11-12.

documents, including the *Securities Law of the People's Republic of China*, the *Provisional Rule on the Administration of Equity Issuing and Trading,* and a host of other regulations and regulatory documents.[213] On January 1, 2006, amendments to the *Company Law of the People's Republic of China* came into effect, which will have a significant impact on how companies are capitalized and how they are governed, in terms of further codification of requirements.[214]

While the history of China's securities law regime is complex and beyond the scope of this report, it is important to note that China has had a troubled and uneven development of its securities law, and in the early 1990s suffered from a serious lacuna of regulatory provisions in respect of disclosure, investor protection and enforcement. Early failures to protect investors, exacerbated by a judicial system that was not responsive to remedying harms to capital market participants led to a crisis of confidence by capital market participants. The flurry of recent regulatory change has attempted to address some of the largest gaps in the regulatory environment, but it is too soon to tell if these regulatory shifts will create meaningful and accessible disclosure or improve protection of investors.

The CSRC regulations on listing disclosure requirements are now highly codified in terms of both registration and prospectus disclosures, including disclosure of investment risks.[215] Disclosure is mandatory in respect of financial information, litigation involving the company, verification of other investments, and development plans. After the securities exchange agrees to list the company, it must make documents related to the approved share listing available for public inspection five days prior to listing.[216]

China has moved quite aggressively into use of technology in primary market disclosure. Effective 2001, upon listing, financial statements, interim announcements and other relevant documentation of companies are required to be entirely disclosed on the websites of the stock exchanges. Companies undertaking IPOs are required to conduct on-line road shows on listing as a disclosure mechanism.

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[213] China Securities Regulatory Commission, *Collection of Laws and Regulations of Securities and Futures of the People's Republic of China*, 2002, www.csrc.gov.cn.
[214] It is too recent to discern the precise impact of these changes, effective January 1, 2006; amendments to *Company Law of the People's Republic of China, 1993,* www.csrc.gov.cn.
[215] CSRC, *Preparation Criteria of Information Disclosure by Companies Offering Securities to the Public,* www.csrc.gov.cn.
[216] *Public Policy 18, Specific Regulations on Information Disclosure by Commercial Banks* with respect to offering of securities. Listing disclosure requires companies to provide documents to regulating bodies and the public when registering to issue stock publicly: a listing report, shareholder resolution, company's articles of association, business license, financial reports from the previous three years or since establishment, a legal opinion and recommendation from a securities company, and the most recent prospectus.

While the use of internet-based disclosure has increased rapidly and resulted in a significant expansion of the amount of information disclosure, the technological advances have also amplified the risks in the market. China faces new challenges of data quality, reliability and the potential abuse of the internet to disseminate misleading information, provide false advice, defraud investors and manipulate the market. Its regulators are currently engaged in a process to ensure the integrity of electronic disclosures, but have yet to publicly announce a strategy to address these new risks. Asymmetries in infrastructure contribute to differentials in timeliness and inequality in accessibility of disclosure between internet and non-internet users.

CSRC regulations regarding listing disclosure requirements go beyond those of China's securities and company laws in their breadth and specificity. In particular, they specify required content and form of prospectus; information to be included in the main text of the prospectus, e.g., information related to the public offering, financial statistics, the interpretation section, investment risks, an explanation of how the capital is to be utilized, the policies on the allocation of share interests, an abstract of the company articles, information regarding the issuer's directors, advisors and high-level managers, past company performance, an asset valuer's report, financial and accounting information, litigation involving the company, verification of other investments, and development plans. As noted above, there are new capitalization requirements under company law amendments, setting a lower minimum capital necessary to establish a publicly traded company.

Hence China appears to be engaged in two simultaneous streams for primary market disclosure as it moves into global capital markets. It has adopted a high degree of codification, driven in part by the need to demonstrate to international investors that as a rapidly emerging capital market, it can provide a degree of certainty and completeness in its disclosure regime. At the same time, however, it offers an extremely integrated use of technology in delivery of that disclosure. While the benefits of web-based disclosure have been recognized by both regulators and market participants, China has encountered challenges in respect of the integrity of the information and the risk of manipulation of those disclosures using the very technology that is assisting in creating access for investors. This is a concern that Canada must be cognizant of this as it moves to a more fully integrated web-based disclosure system.

What is not clear from the information gathered for this report is the degree to which cultural norms in China will inform what happens in practice by issuers in China. In other areas of commercial law, there has been local adaptation of cultural norms such that the existence of an extensive regulatory framework does not necessarily reflect what happens on the ground in commercial dealings.[217]

iii. Plain-Language Initiatives

a) European Union: Plain-Language Initiatives

The *Prospectus Directive* requires that information disclosed in prospectus documents be presented in an "easily understandable and comprehensible form".[218] The summary to the prospectus is limited in word count and is to be written in non-technical language, as discussed above. There are no model documents in the directive that provide an example of plain-language disclosure, although the Directive's requirements throughout emphasize the comprehensibility and comparability objectives.

At the level of Member State implementation, however, one can see how the directive is translated into regulatory requirements. For example, the U.K. Plain Language Commission has specified that plain-language requirements are the writing and setting out of essential information in a way that gives a co-operative, motivated person a good chance of understanding the document at first reading, and in the same sense that the writer meant it to be understood.'[219]

The Commission operates a corporate accreditation program of which the Financial Services Authority (FSA) is an accredited member satisfying the Commission's accreditation criteria. The use of plain language in the FSA's jurisdiction is most evident in the approach to standards for financial product and packaged product disclosure to consumers. For example, the Financial Services Authority "Informing Consumers: Product Disclosure at the Point of Sale" specifies:

It is also clear that some firms have been very successful in the use of plain language – particularly Raising Standards-accredited firms – but that this is by no means true of all. While there is a general requirement in our existing rules to deliver clear, fair and not misleading communications, Raising Standards has dramatically improved the user-friendliness of language used in Key Features Documents.

[217] Examples would be reorganization proceedings and international trade relations.
[218] EU *Prospectus Directive*; *Commission Regulation (EC) No. 809/2004*, *supra*, note 153 at para. 30.
[219] The UK Plain Language Commission uses The Oxford Guide to Plain English (Cutts, Oxford University Press 2004) description of plain English in setting the disclosure objectives.

So we have dealt specifically with the issue of plain language in our proposed rules and guidance, incorporating and expanding on some of the measures applied by Raising Standards.[220]

Research by the U.K. FSA indicated that when consumers do read disclosure information, some have problems understanding what is provided. Hence it has suggested that writing material in plain language is an important part of getting the material understood. It has provided guidance on plain language, but does not require firms to gain plain-language accreditation.[221]

b) United States: Plain-Language Initiatives

Past SEC Chairman Arthur Levitt put plain language at the top of his agenda, providing the impetus for the plain-language initiative at the SEC, including the *Plain Language Disclosure Proposing Release* and the *Plain Language Disclosure Adopting Release* in 1998;[222] and summary of the plain English rules.[223] The plain-language initiatives were in keeping with recognition that increasing numbers of retail investors had entered the market and the wish by securities regulators to place these investors on as even a footing as possible with professional intermediaries and institutional investors.

Rule 421(b) *Entire Prospectus* specifies that issuers are to be clear, concise, and understandable, including short sentences whenever possible; bullet lists whenever possible; descriptive headers and sub-headers. They are to avoid relying on glossaries and defined terms; avoid legal and highly technical business terms; avoid legalistic, overly complex presentations; vague boilerplate language; and excerpts from legal documents and repetition. Rule 421(d) on *Cover and Back Pages, Summary, and Risk Factors* specifies that issuers are to use plain English principles in the organization, language, and design of documents and use short sentences; definite, concrete, everyday words; active voice; tables and bullet lists; no legal jargon or highly technical business terms; no multiple negatives. The rule on *Entire Prospectus—Design* specifies that in designing the entire prospectus, the issuer may use pictures, logos, charts, graphs, or other design elements; is encouraged to use tables, schedules, charts, and graphics for financial data; must draw graphs and charts to scale; and cannot use misleading design and information.

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[220] Financial Services Authority "Informing Consumers: Product Disclosure at the point of sale" (February 2002 Consultation Paper).
[221] *Ibid,* at 5.49.
[222] *Plain Language Disclosure Proposing Release,* Release no. 33-7380; and *Plain Language Disclosure adopting release,* Release no. 33-7497 (January 28, 1998) 63 FR 6370 (Feb 6, 1998); Securities and Exchange Commission (www.sec.gov.).
[223] Extracts from the SEC Handbook "How to create clear SEC disclosure documents" by the Office of Investor Education and Assistance U.S. Securities and Exchange Commission August 1998; Securities and Exchange Commission (www.sec.gov.).

The *Presentation of information in prospectuses* provides specific guidelines on how an issuer must present information in a prospectus.[224]

Proposals by the SEC in early 2006 may require disclosure of executive and board compensation in proxy statements, information statements and annual reports to be in plain language.[225]

The commitment to plain-language disclosure appears to have increased since the corporate and securities scandals. If a goal is to make investors aware of particular risks faced by an issuer, one issue is whether complex risk assessment or description of particular transactions can be realistically described in plain language. It is also far from clear that the U.S. has successfully moved into a plain-language system. It faces many of the same challenges as Canada in finding the appropriate balance between plain-language objectives and the communication of important technical and financial information.

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[224] §230.421 *Presentation of information in prospectuses* specifies (b) You must present the information in a prospectus in a clear, concise and understandable manner. You must prepare the prospectus using the following standards:

(1) Present information in clear, concise sections, paragraphs, and sentences. Whenever possible, use short, explanatory sentences and bullet lists;
(2) Use descriptive headings and subheadings;
(3) Avoid frequent reliance on glossaries or defined terms as the primary means of explaining information in the prospectus. Define terms in a glossary or other section of the document only if the meaning is unclear from the context. Use a glossary only if it facilitates understanding of the disclosure; and
(4) Avoid legal and highly technical business terminology.

Note to §230.421(b): In drafting the disclosure to comply with this section, you should avoid the following:

1. Legalistic or overly complex presentations that make the substance of the disclosure difficult to understand;
2. Vague "boilerplate" explanations that are imprecise and readily subject to different interpretations;
3. Complex information copied directly from legal documents without any clear and concise explanation of the provision(s); and
4. Disclosure repeated in different sections of the document that increases the size of the document but does not enhance the quality of the information.

(d) (1) To enhance the readability of the prospectus, you must use plain English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors section.
(2) You must draft the language in these sections so that at a minimum it substantially complies with each of the following plain English writing principles: (i) Short sentences; (ii) Definite, concrete, everyday words; (iii) Active voice; (iv) Tabular presentation or bullet lists for complex material, whenever possible;
(v) No legal jargon or highly technical business terms; and (vi) No multiple negatives.
(3) In designing these sections or other sections of the prospectus, you may include pictures, logos, charts, graphs, or other design elements so long as the design is not misleading and the required information is clear. You are encouraged to use tables, schedules, charts and graphic illustrations of the results of operations, balance sheet, or other financial data that present the data in an understandable manner. Any presentation must be consistent with the financial statements and non-financial information in the prospectus. You must draw the graphs and charts to scale. Any information you provide must not be misleading.
Instruction to §230.421: Securities Act Release No. 33-7497 (January 28, 1998) for information on plain English principles.

[225] Chair Cox, SEC, *Proposed Revisions to Executive Compensation and Related Party Disclosures* (17 January 2006), http://www.sec.gov/news/speech/spch011706cc.htm at 4.

c) Australia: Plain-Language Initiatives

The ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* has recommended that issuers should provide shareholders with ready access to balanced and understandable information about the company and that notices of meetings should use plain language to clearly and simply communicate information. Issuers are to avoid legal archaisms, unnecessary repetition, and employ a structure and format that ensures readability and ease of understanding by shareholders.[226]

The ASX guidance note on *Review of Operations and Activities* specifies that reviews should be written in a clear style, succinctly, avoiding the use of technical language, be in narrative form supported by figures and graphs where these assist in understanding the matters, and embody the characteristics of reliability, relevance, comparability and understandability.[227]

The ASIC has expressed to the market the expectation that takeover messages are to be tailored to the needs of the new, diverse, less experienced shareholders, using plain English and no jargon. It defines helping consumers make better financial decisions as one of its key strategies.[228]

Yet Australia, as with other jurisdictions, does not appear to have imposed any sanctions or consequences for failure to engage in plain-language disclosures. Hence a further question for Canada is whether any new requirements are aimed at creating a culture of compliance with the plain and accessible parts of "full, true and plain" disclosure, or whether there needs to be some regulatory teeth underlying proposed changes.

d) Japan: Plain-Language Initiatives

There are almost no plain-language initiatives in Japanese securities law. It is only very recently, with the growth in retail investing, that the FSA has recommended that prospectuses be more accessible to

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[226] ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, http://www.asx.com/au/corporategovernance; Guidance Note 9A, at 20.
[227] ASX, *Guidance Note 10, Review of Operations and Activities, Listing Rule 4.10.17*, March 2003 at 8. Like the UK, the use of plain language is most evident in the approach to standards for financial product and packaged product disclosure at consumers. For example, the Australian Securities and Investments Commission (ASIC) booklet, *Your Money,* a free guide which is available to all members of the public written in plain English in order that ordinary members of the public can easily understand the information, and covered topics from budgeting, managing loans and mortgages, and insurance, to getting the most from super, and starting to invest.
[228] Australian Securities & Investment Commission, 05-171 Strategic Plan 2005-10.

ordinary investors. On listing, issuers are to prepare details of investment risk information that is easy to understand for the investing public.[229]

Proposed amendments to the governing ordinance would create a new front section of the prospectus, which would summarize, in plain language, the contents of the prospectus in a form accessible to the individual investor. The entire document, with its more technical analysis, however, would be the basis on which the issuer is held responsible for the disclosure. While these developments appear to be a move towards plain language, one scholar in Japan has suggested that the amendments are aimed more at dealing with the issue of multiple primary disclosure documents, rather than seeking to create a more accessible plain-language disclosure regime.[230]

e) China: Plain-Language Initiatives

To date, we have not been able to locate any plain-language initiatives in Chinese securities regulation.

More generally, the International Organization of Securities Commissions (IOSCO) has had a series of initiatives towards plain-language disclosure, which are referred to by regulators of numerous jurisdictions as informing their initiatives in this area of regulation. For example, the IOSCO Technical Committee has identified a number of principles with respect to MD&A-type disclosure, one of which is that it should be clear, concise and meaningful and in plain language.

iv. Secondary Market Disclosure

In all of the jurisdictions examined, prompt and fair disclosure of information to the public is considered a hallmark of enhancing market integrity and maintenance of investor confidence.

a) European Union: Secondary Market Disclosure

Secondary market disclosure initiatives have been aimed at creating uniformity of secondary market disclosure in the EEA, but have also been developed to respond to the growing use of technologies to disseminate information and as a response to the U.S. *Sarbanes-Oxley Act* and its subsequent measures.[231]

[229] TSE Application Checklist, *supra* note 196 at 49.
[230] Professor Masafumi Nakahishi, Nagoya University Faculty of Law, March 2006 exchange of e-mails.
[231] *Opinion of the European Economic and Social Committee on the 'Proposal for a Directive of the European Parliament and of the Council on the Harmonization of Transparency Requirements with regard to information*

The objective of the European Commission Directive on the *Harmonization of Transparency Requirements in Relation to Information about Issuers whose Securities are Admitted to Trading on a Regulated Market* (the "*Transparency Directive*") is to ensure investor confidence through equivalent transparency in disclosure throughout the European Community.[232] The Directive specifies that in its implementing powers in respect of the directive, the Commission should respect the principles of ensuring confidence in financial markets by promoting high standards of transparency; recognizing the need to provide investors with a wide range of competing investments and a level of disclosure tailored to their circumstances; consistency in enforcement of disclosure rules; and balancing the costs and benefits to market participants on a long-term basis, including small and medium-sized businesses and small investors.

The *Transparency Directive* specifies that the disclosure of accurate, comprehensive and timely information about securities issues builds sustained investor confidence and allows an informed assessment of issuers' business performance and assets, which in turn enhances both investor protection and market efficiency.[233] Issuers are to ensure appropriate transparency through a regular flow of information. The Directive does not affect the home Member State's right to request the issuer to publish, in addition, parts or all of the regulated information through newspapers.[234]

The Directive also specifies that there must be transparent disclosure in respect of persons and legal entities holding voting or financial instruments that result in an entitlement to acquire existing shares with voting rights, and they are to inform issuers of their acquisition of major holdings in companies, so that issuers are in a position to keep the public informed of major capital movements and changes in voting structure.[235] The extensive codification in this area may be a result of the history of closely held and block holdings in securities, and the control shifts that accompany transfer of those holdings. Considerable attention is paid to these disclosure requirements in the Directive.[236]

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about issuers whose securities are admitted to trading on a regulated market and amending directive 2001/34/EC", OJ C80/128, 30.4.2004 at para. 1.2.

[232] *Transparency Directive, supra*, note 136 at para. 41.

[233] *Ibid.* at para. 1 of preamble. The directive is aimed at greater harmonization of periodic and ongoing information requirements throughout the Community.

[234] *Ibid.* at para. 8.

[235] *Ibid.* at paras. 2, 18 and Chapter III, Article 9. The directive specifies that supervision of an issuer of shares or debt securities the domination per unit of which is less than EUR1000 for purposes of the directive, would be best effected by the Member State in which the issuer has its registered office, but that it is vital to ensure consistency with Directive 2003/71/EC on prospectus publishing requirements when securities are offered to the public or admitted to trading.

[236] *Ibid.* at Chapter III, Articles 9 to 16.

An earlier EC regulation on application of international accounting standards went some measure towards convergence of financial reporting standards, providing the groundwork for the *Transparency Directive* to require more harmonized annual and interim financial reporting.[237] The requirement is to provide a "true and fair view" of the issuer's assets, liabilities, financial position and profit or loss.[238]

The *Transparency Directive* specifies that ongoing disclosure to securities holders should continue to be based on the principle of parity in treatment.[239] The Directive introduces more comprehensive half-yearly financial reports; and allows Member States to provide for exemptions from half-yearly reporting by issuers of debt securities in particular circumstances such as credit institutions acting as small-size issuers of debt securities.[240]

The *Transparency Directive* also notes that any obligation for an issuer to translate all ongoing and periodic information to all relevant languages in all Member States where its securities are traded does not foster integration of securities markets, but rather, has deterrent effects on cross-border admission to trading.[241] Thus the Directive specifies that issuers should, in certain cases, be entitled to provide information and required notifications drawn up in the language that is customary in the sphere of international finance, in order to attract investors from other Member States and third countries.[242]

The *Transparency Directive* also encourages rapid access to information for investors. There are also disclosure requirements in respect of information that is to be provided to investors such that they can exercise their rights in the home Member States in terms of information on shareholder meetings; proxy disclosure; and voting requirements (including by electronic means where applicable). The Directive allows issuers to use electronic means to convey information to shareholders, provided such a decision was taken at a general meeting of shareholders and meets specified conditions, including: the use of

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[237] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, OJ L 243, 11.9.2002.
[238] *Transparency Directive, supra*, note 136 at para. 9.
[239] *Ibid.* at para. 22.
[240] *Ibid.* at para. 12.
[241] *Ibid.* at para. 24.
[242] *Ibid.* at para. 24 and Chapter IV, Article 20. Where securities are traded only in one Member States, disclosure shall be in the language accepted by the competent authority in the home Member State. Where securities are traded both in the home Member State and one or more Member States, regulated information shall be disclosed in the language accepted by the member State and depending on the choice of the issuer, either in a language accepted by the competent authorities of the host Member States or in a language customary in the sphere of international finance. Where securities are admitted to trading on a regulated market without the issuer's consent, the language obligations shall not be incumbent on the issuer, but upon the person who, without the issuer's consent, had requested such admission. Where securities per unit are at least EUR 50000, disclosure shall be in either the language of the home or host Member State or in a language customary in the sphere of international finance, at the choice of the issuer or person who, without consent of the issuer requested such admission.

electronic means should not depend in any way on the location of the shareholder; the means must ensure full access to information; and deemed consent to use electronic means where shareholders do not object within a specified period after notification.[243] The Directive specifies that shareholders shall be able to request, at any time in the future, that information be conveyed in writing instead of electronically.[244] Hence the shift towards electronic disclosure, while facilitating such disclosure through deeming provisions, still provides investors with a basic right to return to paper-based delivery of required proxy and other information.

In respect of debt securities, the *Transparency Directive* specifies that the issuer has an obligation to ensure that all holders of debt securities ranking *pari passu* are given equal treatment in respect of all rights attaching to the securities, including disclosure obligations.[245] Similar provisions are included in respect of electronic disclosures.

It is left to Member States to formulate guidelines for setting up electronic networks with issuers and other market participants.[246] However, the Directive is also aimed at encouraging disclosed information to be more organized at the Community level, so that investors not situated in the issuer's home Member State are on an equal footing with domestic investors in terms of access to information regarding the issuer. This includes Member States ensuring compliance with minimum quality standards for disseminating information throughout the Community in a fast but non-discriminatory basis. It also includes centralizing disclosure information within the Member State, which will allow a European network of access to information to be established.[247]

The *Transparency Directive* sets out interim reporting requirements, including audited financial statements and management reports. It requires statements to be made by persons responsible within the issuer that to the best of their knowledge, the financial statements are prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer and the undertakings, including in the consolidation taken as a whole. They must confirm that the management report includes a fair review of the development and

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243 *Ibid.* at Chapter III, Article 17.
244 *Ibid.*
245 *Ibid.* at Chapter III, Article 18.
246 *Ibid.* at para. 26.
247 *Ibid.* at paras. 25, 28 and Chapter IV, Article 21. The Directive specifies that a single competent authority should be designated in each Member State to assume final responsibility for supervising compliance with the Transparency Directive.

performance of the business and the position of the issuer, together with a description of the principal risks and uncertainties that they face.[248]

The Member States continue to be entitled to specify liability rules under national law or regulation for failure to meet disclosure requirements.[249] There are exemptions to some requirements under the Directive, based on value of securities and type of issuer.[250] The *Transparency Directive* is also aimed at recognizing disclosure equivalencies for third countries, those outside the EU, including financial statements and information.[251] The EU *Transparency Directive* must be implemented by January 20, 2007. On implementation, Member States will be able to impose stricter restrictions that the minimum.[252] The Directive includes a mandatory review and report to the European Parliament by June 30, 2009 on the operation of the Directive.[253]

There are a series of other directives, aimed at disclosure requirements. This includes a Directive on defining insider information in relation to derivatives on commodities, and notification of suspicious transactions in order to identify possible market abuse, expressly aimed at transparency of market practices and allowing competent authorities an additional means to supervise markets.[254] Hence, disclosure as a policy instrument is advancing simultaneous goals of securities regulation.

The Directives also set standards for regulators to publicly disclose their decisions regarding the applicability of the disclosure practice concerned, including a description of factors taken into account in determining whether the relevant practice is acceptable and whether this conclusion aligns with or differs from conclusions by regulatory authorities in other Member States. The regulatory authority must also transmit decisions on a timely basis to the Committee of European Securities Regulators, which shall then

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[248] *Ibid.* at Chapter II, Article 4.
[249] *Ibid.* at para. 17 and Chapter II, Article 7.
[250] *Ibid.* at Chapter II, Article 8.
[251] *Ibid.* at Chapter IV, Article 23.
[252] For example, the proposed German rule to tighten rules in 2006 regarding disclosure of shareholdings to reduce threshold reporting at 3% of acquisition of shares, which brings Germany in line with U.K., but out of line with other EU member countries' requirement of 5%.
[253] *Transparency Directive, supra*, note 136 at Chapter VI, Article 33.
[254] Commission Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC of the European Parliament as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions, OJ L 162, 30.4.2004, 0070-75 at paras. 4-7. There is also a proposed EU paper on competition, issued December 2005, which outlines a policy and disclosure framework based on "likely effects in the market" and the protection of competition as a means of enhancing consumer welfare.

make them immediately available on its website.[255] Hence, the "disclosure of disclosure decisions" attempts to provide issuers and other market participants with timely and accessible information regarding accepted practice and how it may differ among Member States. One question is whether Canada should adopt a similar uniform transparency requirement for its regulators.

The *Directive on Insider Dealing and Market Manipulation* ("*Market Abuse Directive")* was promulgated in 2003.[256] The objective of the directive is to ensure integrity of EU financial markets and to enhance investor confidence through a combination of prohibitions and disclosure of particular transactions. The Directive notes that failure to have prompt and fair disclosure of information to the public can harm investor confidence in market integrity. It requires a series of measures to combat market abuse, including greater transparency of transactions conducted by managers and persons closely associated; a prohibition on insider use of particular insider information; timeliness of disclosure of inside information; and measures to ensure harmonization of technical modalities, condition and arrangements for disclosure.

The preamble to the *Market Abuse Directive* notes that reasonable investors base their investment decisions on information already available to them.[257] The implementing directive specifies that for purposes of applying Directive 2003/6/EC, "'information, which, if it were made public, would be likely to have a significant effect on the prices of financial instruments or related derivative instruments' shall mean information a reasonable investor would be likely to use as part of the basis of his investment decisions".[258] The issuer can delay disclosure of insider information in stringently defined special circumstances, in order to protect the legitimate interests of investors; however, it must prevent disclosure that would allow insider trading.[259] The issuer must disclose any "significant change" concerning already publicly disclosed information promptly after the changes occur.[260] The Directive states that Member States shall require issuers to take reasonable care to ensure that disclosure of inside information to the

[255] *Ibid.* at Article 3. The Committee of European Securities Regulators was established by Decisions 2001/527/EC and amended by 2004/7/EC: Commission Decision of 5 November 2003 amending Decision 2001/527/EC establishing the Committee of European Securities Regulators, OJ L 003, 7.1.2004, 0032-0032.
[256] *Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on Insider Dealing and Market Manipulation* (Market Abuse Directive), OJ L 096, 12.4.2003, 0016-0025; *Commission Directive 2003/124/EC of 22 December 2003 Implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation*, OJ L 339, 24.12.2003, at 0070-0072.
[257] *Ex ante* information.
[258] *Commission Directive 2003/124/EC , ibid.* at para. 2. In "in making an investment decision, a reasonable investor would be likely to take into account a particular piece of information', such an assessment "has to take into consideration the anticipated impact of the information in light of the totality of the related issuer's activity, the reliability of the source of information and any other market variables likely to affect the related financial instrument or derivative financial instrument" in the circumstances; *Directive 2003/124/EC, ibid.* at para. 1.
[259] *Ibid.* at para. 5 and Article 3.
[260] *Ibid.* at para. 3.

public is synchronized as closely as possible between all categories of investors in all Member States in which the issuer is trading.[261]

Under the *Market Abuse Directive*, Member States are able to choose the most appropriate way to regulate persons producing or disseminating research concerning financial instruments, issuers of financial instruments and analysts disseminating information or recommending investment strategies. Guidance by the Member State is to be in conformity with provisions of the Directive, including specific provisions directing information-sharing and co-operation. Market operators are to adopt structural provisions aimed at detecting and protecting market manipulation. The principal tool is transparency of transactions concluded, and prompt and effective sanctions for infringement of prohibitions.[262]

The *Transparency Directive* and the *Market Abuse Directive* are initiatives in the move towards a common financial market. Another is the EU harmonized accounting under the International Financial Reporting Standards (IFRS) for company financial statements, effective January 1, 2005. The goal is enhanced transparency by making accounts easier to produce and compare. There have been transition costs and problems. The IFRS requires companies to publish previously unreported figures. Early indications are that accounts have not converged because companies are given leeway under IFRS to make different accounting choices and there are high transaction costs to explaining changes to investors. However, the requirements have brought greater transparency, particularly in reporting pension deficits and derivatives and bringing some uniformity to financial reporting.

In the U.K., the Turnbull Guidance (2000), the equivalent of *Sarbanes-Oxley* requirements, covers operations and financial controls, but uses a principles-based approach. The updated Guidance was to be effective in January 2006, recommending that boards confirm when they take action to remedy significant failings. There is no requirement for directors to make a statement in the issuer's annual report on the effectiveness of the issuer's internal control system similar to *S-Ox* 404. The Turnbull Guidance is an example of where a Member State has followed a direction that differs from the EU framework, which suggests codifying the role and responsibilities of the audit committee in monitoring the integrity of financial statements and any formal announcement relating to the company's financial performance.

In summary, the EU developments in secondary market disclosure have largely adopted a strong codification approach, aimed at harmonization of standards. While the degree of codification is very

[261] *Ibid.* at Article 2, para. 4
[262] *Directive 2003/6/EC, supra*, note 257 at para. 38.

high, at least at the directives level, the directives themselves are written in clear, plain language and are relatively accessible in their content requirements for Member States and market participants. It highlights that a benefit of codification can be certainty in requirements, particularly when one is dealing across jurisdictions and languages. Canadian regulators might also benefit from the EU experience in moving towards a more fully integrated electronic disclosure regime, which retains paper-based disclosure on an investor demand basis.

b) United States: Secondary Market Disclosure

There have been extensive revisions to secondary market disclosure with the *Sarbanes-Oxley Act, 2002* and subsequent regulatory amendments.[263] *Sarbanes-Oxley* was enacted to mandate a number of reforms to enhance corporate responsibility and financial disclosure, and to combat corporate and accounting fraud. It also created the Public Company Accounting Oversight Board to oversee the activities of the accounting profession. The requirements are increasingly codified, with stringent disclosure requirements, as well as enhanced requirements for board and audit committee oversight. SEC rules since 2002 have included (but not limited to): implementing accelerated filing deadlines for change of beneficial ownership reports;[264] certification of disclosure by the issuer's principal executive and financial officers;[265] new disclosures regarding audit committee financial experts;[266] new disclosure requirements regarding whether the issuer has a financial expert serving on the audit committee;[267] requirements for accounting firms to retain certain audit and other records;[268] conditions for use of non-GAAP methodologies in public company disclosures;[269] requirements regarding disclosure of off-balance sheet arrangements in MD&A and aggregate contractual obligations;[270] enhancing auditor independence requirements;[271] and electronic filing and website posting of requirements for insider transactions.[272] There were also requirements regarding management reporting on internal controls over financial reporting and certification of disclosures in *Securities Exchange Act* required periodic reports, frequently referred to as *S-Ox* 404 requirements, as they are specified under that section of the *Sarbanes-Oxley Act.*

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[263] For example, the 2002 revised *Uniform Securities Act*, aimed at further harmonization of federal and state securities law.
[264] Section 403, *Sarbanes-Oxley Act,* amending s. 16(a), *Securities Exchange Act, 1934.*
[265] Section 302(a), *Sarbanes-Oxley Act.*
[266] Sections 302, 406 and 407, *Sarbanes-Oxley Act.*
[267] Sections 406, 407, *Sarbanes-Oxley Act.*
[268] Section 802, *Sarbanes-Oxley Act.*
[269] Section 401(b), *Sarbanes-Oxley Act.*
[270] Section 401(a), *Sarbanes-Oxley Act.*
[271] Sections 201-208, *Sarbanes-Oxley Act.*
[272] Section 403, *Sarbanes-Oxley Act* and s. 16(a), *Securities Exchange Act, 1934.*

In respect of material change disclosure, *Sarbanes-Oxley* section 409 requires issuers to disclose information about material changes in their financial condition or operations on a "rapid and current" real time basis. The SEC rules, effective August, 2004, required companies to report within deadlines shortened to four business days.[273] One question is whether issuers have been including minor announcements that do not materially impact financial statements, given the risk of liability. One area, in particular, that has seen significant increase in disclosure is in relation to executive compensation.

Sarbanes-Oxley also significantly shortened the deadlines under which directors, officers and major shareholders of SEC-reporting companies (other than foreign private issuers) must report transactions in the company's shares. Such reports must now be filed electronically and must be posted on the company's website.

Sarbanes Oxley section 404 directed the SEC to adopt rules requiring issuers, other than registered investment companies, to include in their annual reports a statement of management's responsibility for establishing and maintaining adequate internal controls over financial reporting and assessing the effectiveness of those internal controls. The company's auditors are to attest to and report on this management assessment. The objective of the provisions was to enhance confidence in financial reporting because internal controls over that reporting would be effective and timely. The SEC adopted rules for management assessment in 2003 and requirements for the audit of companies' internal controls in 2004, known as the *S-Ox* 404 requirements.[274] The original compliance date for *S-Ox* 404 rules was June 15, 2004 for accelerated filers and April 15, 2005 for non-accelerated filers and foreign private issuers.[275] These dates were subsequently changed to November 2004 and July 2005, and then further extended for foreign private issuers to fiscal years ending after July 15, 2006 and for non-accelerated filers to fiscal years ending after July 15, 2007.[276] In part, the delayed timing has been because the costs of *S-Ox* 404 compliance have been much greater than anticipated. The SEC reports that a study by the Big Four Accounting firms found that second year total costs, after initial development of controls

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[273] Form 8K.

[274] SEC Release No. 33-8238, (5 June 2003) 68 FR 36636; SEC Release No. 34-49884 (17 June 2004) 69 FR 35083. The SEC adopted the PCAOB Auditing Standard, which established the requirements that apply to an independent auditor when performing an audit of the company's internal control over financial reporting; SEC Release No. 34-49884, *ibid.*

[275] Accelerated filer is a defined term under Rule 12b-2, 17 CFR 240.12b-2, under the *Exchange Act*, 15 U.S.C 78a *et seq*.

[276] SEC Release No. 33-8545 (22 September 2005) 70 FR 11528.

reporting, for public companies with a market capitalization of $75-700 million was on average $900,000.[277]

Smaller companies have had difficulty in working towards compliance with *S-Ox* 404 rules, specifically because of lack of guidance in the requirements in terms of application to smaller companies, a compliance model that discourages use of business judgment and a disproportionate cost burden that some scholars have suggested could pose significant risks to economic growth in U.S. capital markets.[278] The SEC Advisory Committee on Smaller Companies found that the disproportionate cost burden was due to fewer internal personnel to comply and less revenue to offset implementation costs.[279] It has recommended that management representations as to the effectiveness of internal controls should be sufficient for smaller companies and that external audit involvement should not arise until the public company reaches a certain size and complexity.[280] It also reported that the risk of management override is a key risk for smaller companies because of top management's wider span of control, and that effective entity level internal controls and increased board oversight are needed to prevent such override from occurring.[281]

While smaller companies could opt-in to *S-Ox* 404 requirements, the SEC Advisory Committee has recommended exemptive relief for some micro- and small-cap companies where they adhere to *SEA* standards regarding audit committees; have adopted a code of ethics within the meaning of SEC regulations and have designed and maintained effective internal controls over financial reporting.[282] The majority of the Committee also recommended that companies would also have to comply with SEC requirements to maintain and disclose a system of effective control over financial reporting, disclose modifications to such internal controls and their material consequences, apply CEO and CFO certifications to these disclosures, and report on any known material weakness.[283] There are more than a hundred pages of recommendations and commentary as to how to target disclosure and internal controls for smaller public companies.[284]

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[277] SEC, Exposure Draft, *supra* note 182 at 29.
[278] W. Carney, "The Costs of Being Public After S-Ox: The Irony of Going Private", Emory Law and Economics research Paper No. 05-4 (February 2005), SSRN, www.http//ssrn.com/abstract=672761;
R. Romano, "The *Sarbanes-Oxley Act* and the Making of Quack Corporate Governance (2005) 114 Yale Law Journal 1521.
[279] SEC, Exposure Draft, *supra* note 182 at 20, 23.
[280] *Ibid.* at 28.
[281] *Ibid.* at 32, 34.
[282] *Ibid.* at 40.
[283] *Ibid.* at 40-41.
[284] The SEC has requested comments on the *Exposure Draft of Final Report of the Advisory Committee on Public Smaller Companies* by April 3, 2006; FR 71-42.

eXtensible Business Reporting Language (XBRL)

The SEC is promoting a new electronic platform or business reporting language for delivering disclosure of the numbers in financial statements; a reporting language that can perform fast and flexibly, reducing cost and inefficiency. The platform is called eXtensible Business Reporting Language (XBRL) and it is being developed by an international consortium of 400 major companies, organizations and government agencies. The SEC has introduced a voluntary XBRL filing program. XBRL is also being tested in Europe and other jurisdictions, and there is now "XBRL Canada" as a member of the international non-profit consortium promoting the use of this electronic business reporting language.[285]

XBRL attaches electronic tags to elements of information; the tags indicating particular items on financial statements. The electronic tags are standardized, regardless of the XBRL-enabled software application that is used to read the XBRL data file. The tagged data can then be pulled out of the comprehensive electronic disclosures, allowing easy and improved access to information. The tagging allows investors to draw out the information they are interested in examining on a selective basis. The tagging also allows software programs to calculate ratios and perform other analyses without having to re-input financial data, providing enhanced access to information for analysts and other financial intermediaries.

Christopher Cox, Chair of the SEC has said that XBRL "will level the playing field for tens of millions of average investors", empowering everyday investors to make better investment decisions.[286] XBRL allows users to take "huge amounts of financial data and make it searchable, accurate, and most important, usable".[287] The drive behind that initiative is the SEC's conclusion that the solution to accessible disclosure to retail issues is not to eliminate detailed information and replace it with summaries or consolidations, as this would "be dumbing down the data".[288] Rather, with interactive data on XBRL, each investor is able to order up his or her own custom model with "just a few clicks of the mouse". The information is called up instantly to one page, removing the necessity of culling through data where originally entered. If the platform is as easy and accessible as the SEC believes, this could revolutionize electronic disclosure.

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[285] XBRL Canada, http://www.xbrl.ca.
[286] Christopher Cox, Chair of the SEC, *Proposed Revisions to Executive Compensation and Related Party Disclosures* (17 January 2006), http://www.sec.gov/news/speech/spch011706cc.htm at 3.
[287] Christopher Cox, Chair of the SEC, Speech to Practitioners Law Institute, SEC Speaks Series (3 March 2006), http://www.sec.gov/news/speech/spch030306cc.htm.
[288] *Ibid.*

About 30 U.S. filers are currently using the XBRL system on a pilot basis and more are about to begin. The SEC is offering incentives for additional companies and funds to join its voluntary XBRL filer program. Registrants who commit to filing in XBRL for a year, and to providing the SEC feedback on their experiences, will get expedited reviews of their securities registrations and will be advised sooner as to whether the SEC will review their 10K annual reports.[289] The deadline was March 10, 2006. It will be interesting to monitor market experience with the platform.

This brief discussion gives at best a superficial description of the extensive secondary market disclosure revisions made in the past five years in the U.S.. Now that there is some experience with the disclosure requirements, the question is whether there was over-codification in reaction to the corporate scandals and whether the level of codification creates a "tick-the-box" approach to securities compliance, instead of creating a compliance culture. The debate in the U.S. in this respect is similar to the normative differences between Canadian securities regulators regarding the amount of codification required, as discussed earlier in this report. What is evident is that the amount of required disclosure does not appear to assist retail investors to make informed decisions, because the sheer myriad of rapidly changing regulatory requirements means that the information is not easily accessible to the ordinary investor. Efforts at some plain language disclosure are unlikely to fully address the barriers created by locating secondary market disclosures in so many separate rules and filing documents.

c) Australia: Secondary Market Disclosure

The *Corporate Law Economic Reform Program Act* (CLERP) has embarked on nine areas of reform over a number of years, including moving auditing standards to international accounting standards;[290] making access to capital easier for small issuers;[291] introducing a new business judgment rule to provide more certainty to directors, encourage timely, accurate disclosure of information and create new shareholder rights to take action on behalf of the company;[292] improving takeover regulation to promote a more competitive market;[293] adapting regulations to facilitate electronic commerce;[294] providing a regulatory

[289] Christopher Cox, Chair of the SEC, Speech to XBRL conference (18 January 2006), http://www.sec.gov/news/speech/spch011806cc.htm.
[290] *Corporate Law Economic Reform program (Audit Reform and Corporate Disclosure) Act* (CLERP); CLERP 1 Auditing Standards, applying to financial reporting periods after January 1, 2005.
[291] CLERP 2 Fundraising.
[292] CLERP 3 Directors' Duties and Corporate Governance. It also facilitates shareholder participation.
[293] CLERP 4 Takeovers.
[294] CLERP 5 Electronic Commerce.

structure for financial markets, products and issuers;[295] simplified compliance;[296] and encouraging full and timely corporate disclosure and promoting the credibility of financial information through audit independence.[297]

Australia is moving towards a principles-based regulatory approach, and is currently engaged in a comprehensive assessment of alternatives to rule making before imposing rules. It is focused on simplifying the reporting regime and reducing the burden of compliance while enhancing quality and timeliness of information to the market.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act* (CLERP 9), enacted in 2004, focuses on transparency and open communications; continuous disclosure; financial reporting; audit reform and auditor independence and enforcement.[298] CLERP 9 is aimed at "new, clear, concise and effective disclosure obligations" in the issuing of securities.[299] Issuers are to disclose material information on a timely basis and comply with any relevant listing rules, aimed at transparency and equal access to information. Preliminary final reports require a true-results focused preliminary announcement that comprises an announcement of the results for period and commentary.[300] The ASX proposals examine accelerating the obligation in annual reporting requirements to report on "material effects". The overriding rule to all financial transactions is a prohibition on any person from engaging in misleading or deceptive conduct.

The CLERP continuous disclosure enhancements include additional disclosures in directors' reports and auditors' reports. Directors must set out their reason for forming the opinion that the inclusion of additional information was necessary and specify where the information is located in the report**.**

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[295] CLERP 6 Financial Products, Service Providers and Markets, which includes more consistent and comparable regulation for securities, futures, derivatives, superannuation, insurance and other products.
[296] CLERP 7 Simplified Lodgments and Compliance.
[297] CLERP 8 Corporate Disclosure
[298] *Corporate Law Economic Reform program (Audit Reform and Corporate Disclosure) Act,* (July 2004), amending the *Corporations Act, 2001*, enacted July 2004, http://www.asic.gov.au.
[299] ASIC has series a series of policy statements in respect of disclosure requirements, including Policy Statement 168: Disclosure: Product Disclosure Statements and other disclosure obligations; and Policy Statement 152: Lodgement of Disclosure Documents; revised Practice Note 66, transaction-specific disclosure; and Policy Statement 173 on disclosure of on-sale securities and other financial products, 04-73 ASIC final versions of CLERP 9, http://www.asic.gov.u.
[300] Half yearly minimum disclosures by accounting standards plus a few specified other disclosures.

CLERP amends the *Corporations Act* so that civil liability in relation to continuous disclosure breaches will be extended to individuals, not just the company. The amendments also provide for proportionate liability, rather than joint and several liability in respect of misleading or deceptive conduct.

Under *Corporations Act*, companies are required to include in notes to financial statements any additional information necessary to give a "true and fair view" of the company's financial position and performance. The ASX requires that CEO and CFOs make a formal declaration to their board of directors that the financial records have been maintained in accordance with the *Corporations Act* and that the financial statements comply with accounting standards. The ASX Listing Rules require listed entities to include a comprehensive review of operations and activities in the annual report. The *Corporations Act* defines material effect as "if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether or not to buy or sell".

CLERP 9 introduced a new remedy in the form of an infringement notice for breaches of continuous disclosure obligations set out in ss. 674(2) and 675(2) of the *Corporations Act,* with fixed penalties for breach of the continuous disclosure regime.[301] This is a remedy designed to address less serious breaches of disclosure obligations, filling a gap in the enforcement framework. The infringement notice is to provide a fast, effective, proportionate remedy.[302] Shareholder class actions for continuous disclosure violations are now emerging, with the ASIC providing some co-operation in terms of investigation disclosures.

The ASX also issues guidance notes for issuer disclosure obligations to meet its listing rules. For example, listing rule 4.10 specifies that an entity must include a Review of Operations and Financial Condition for the reporting period.[303] The Review complements and supplements the financial statement, where the company explains its past performance and provides information that will increase understanding of its future directions, concentrating on the opportunities and risks associated with past operations and with future activities. The ASX Guidance Note specifies that the Review should be comprehensive and include matters that are likely to be significant to users; update material comments or

[301] Australian Securities & Investment Commission, *Continuous Disclosure Obligations: Infringement Notices*, May 2004 at 3, ASIC, *Corporate Law Economic Reform Program*, http://en.wikipedia.org/wiki/Corporate_Law_Economc_Reform_Program_Act_2004 at 4, part 9.4AA.. Penalties can range from $33,000 to $100,000, depending on whether the entity is a listed company and whether there has been a previous contravention of continuous disclosure requirements.

[302] *Ibid.* at 4.

[303] ASX, *Guidance Note 10, Review of Operations and Activities, Listing Rule 4.10.17*, published in September 1999, revised and republished March 2003.

disclosures made in previous reports where actual outcomes warrant such updating; make clear how financial or non-financial key performance indicators, ratios or other information relate to the financial statements; include a discussion of initiatives, events and transactions that can be expected to affect future reporting periods; explain sources, assumptions and adjustments to financial and non-financial measures; and finally, deal with the broader dimensions of the company's performance, such as sustainability reporting, which is relevant to investors.[304]

Australians have moved to electronic based disclosure. The ASX company announcements platform (CAP) required use of electronic filing of company announcements effective July 2003.[305]

CLERP establishes a Financial Reporting Panel (FRP) that will resolve disputes between companies and the ASIC concerning accounting treatments in financial products, allowing for dispute resolution by individuals with specialized expertise. While the findings will not be binding on the parties, it is hoped the parties will be content with the resolution of the particular dispute; however, they can retain the option of taking the matter to court for a binding resolution.

CLERP 9 also amends s. 300A to require disclosure of remuneration of directors, both by the issuer and across an entire corporate group, and disclosure of the remuneration policy so that investors can understanding the nature of the remuneration, including any performance hurdles or contingencies, and so that they can understand the relationship between performance and remuneration. Shareholders must be given an opportunity to ask questions regarding the remuneration disclosure at the annual general meeting and must vote on the report.

While Australia is in early stages of moving towards a principles-based disclosure regime, it merits watching as Canada considers the appropriate balance between rules-based and principles-based disclosure. Many of the same issues regarding the incentive effects of particular choices on market participants, discussed earlier in this report, are likely to be encountered in the Australian system as it shifts its disclosure regime.

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304 *Ibid.* at 7.

305 Using the electronic facility, ASX Online. ASX, *Guidance Note 14, Company Announcements Platform,* January 2003 and ASX *Guidance Note 20, ASX Online*.

d) Japan: Secondary Market Disclosure

Continuous disclosure obligations include filing interim and annual reports; disclosure of financial and other information to registered and beneficial securities holders; required disclosure of information significantly affecting investors' decisions; and announcements of business results and material corporate information to public investors.[306] The opinion of an auditor must be sought regarding the content of the disclosures, and issuers must hold meetings with analysts and investors at least twice in each of the three years from date of listing.[307] Each issuer must designate a "Corporate Information Handling Officer" to keep close contact with the TSE and enhance timely disclosure.[308] There is a general obligation to disclose in a manner that is "swift, accurate and fair" in order to foster a fair working securities market, enforcing the rules on disclosure of corporate information set under the *Securities and Exchange Law.* Issuers are also required to have systems in place capable of supporting continuous, timely and adequate legally required periodical and material information disclosures.[309] The TSE publishes guidelines for the timely disclosure of important corporate information resulting from business activities, and provides an electronic filing system that facilitates investor access to disclosure documents.[310]

The TSE requires listed companies to disclose immediately to the public "any information that might be expected to materially affect the prices of its stocks", including financial results, capital changes, occurrence of a material fact such as a major change to shareholders, legal action or decision, and any significant change of laws in home jurisdiction.[311] The TSE specifies an extensive list of business results and other corporate information that it considers material information such that it must be disclosed, including, capital structure changes, occurrence of material facts such as finalized business results, earnings forecasts, initiation of litigation; judicial decisions; or commencement of reorganization procedures, takeover offers and mergers. The stock exchanges must ensure that the trading of securities is carried out in a fair and efficient manner, with the protection of the public interest and investors as a primary goal.[312]

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[306] TSE Rules on Timely Disclosure, http://www.tse.or.jp/english, at 75-76.
[307] *Ibid.* at Article 3, para. 2, item 10(b).
[308] *Security Listing Regulations and Supplementary Rules to Security Listing Regulations,* 10 December 2003, at Part III, Disclosure Requirements after Listing.
[309] TSE Application Checklist, *supra* note 196, at 49.
[310] *Ibid.* at 1-2.
[311] TSE Disclosure Requirements, http://www.tse.or.jp/english/about/organization.html.
[312] TSE Organizational Structure and Major Functions, http://www.tse.or.jp/english/about/organization.html, 12/15/2005.

Effective April 2003, Japan moved to requiring quarterly disclosure from listed companies, in order to ensure that investors received more timely information.[313] Prior to that time, only 15% of listed issuers released quarterly statements, and only half of those disclosed financial information.[314] The new requirements were aimed at achieving greater transparency and comparability in secondary market disclosure.

The principal exchanges in Japan, the TSE, the Jasdaq Securities Exchange and the Osaka Securities Exchange are all on electronic platforms, using electronic disclosure tools. There have been some computer problems with the trading platform, but there is no discussion translated into English regarding difficulties in disseminating disclosure information.[315]

With the recently emerging hostile takeover market, further proposed changes to securities law are expected in 2006, aimed at reducing information asymmetries and increasing transparency. Under current securities law governing mergers and share swaps, Japanese companies are only required to file a brief report that does not include detailed disclosure of up-to-date financial information, risk factors and other information.[316] The FSA may need more aggressive investigative and enforcement powers, and the requisite resources, to effectively enforce secondary market violations. There has also been some discussion of whether the SESC, currently an arm of the FSA, needs to be separated in order to ensure some independence in its enforcement activities. The *Bill to amend the Securities Exchange Act* was submitted to the Diet May 13, 2005, and is scheduled to pass by the end of June 2006. If the Bill is enacted, the *Securities Exchange Act* will be renamed as the *Financial Commodities Exchange Act* (referred to as the Investment Service Act) at the final stage. It would implement a three-step enforcement regime.[317]

Lifting the ban on holding-group companies and financial holding companies and enabling mergers, acquisitions and reorganizations in the period from 1997-2002 was accompanied by revisions to securities law imposing obligations to compile and disclose consolidated financial statements and to apply tax-effective accounting. The 1999 Revision to regulations on Financial Statements imposed obligations to

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313 TSE Board Report, *Revisions to Establish Quarterly Disclosure for Listed Companies*, http://www.tse.or.jp/english/guide/b_report/0212.html, December 2002.
314 *Ibid.* at 2.
315 Michiyo Nakamoto, "Glitches prompt rethink on Tokyo exchange, 2 January 2006.
316 American Chamber of Commerce in Japan.
317 There is not yet any English translation of this Bill; the information was supplied by Professor Nakahigashi of Nagoya University, (20 March 2006).

incorporate R&D costs into accounting statements. In 2005, guidelines were also promulgated for application of accounting standards for asset impairment of fixed assets.

One of the most serious challenges for secondary market disclosure in Japan is the lack of enforcement mechanisms. The FSA and the SESC did not historically monitor and enforce continuous disclosure obligations and had taken almost no action on disclosures. Japan also has no mechanism for private enforcement through class-action lawsuits. Changes to accounting standards that from 1998 to 2001 increased the quality of Japanese corporate disclosure through imposing obligations on publicly traded companies to compile and disclose consolidated financial statements, as well as requiring Japanese companies to carry their cross shareholdings at market value instead of book value and implement mark-to-marketing accounting for financial products and other securities.[318]

Listed foreign companies must appoint an attorney-in-fact residing in the Tokyo area to fulfill the continuous disclosure obligations. As with all listed companies, the issuer must designate a Corporate Information Handling Officer to keep close contact with the TSE and enhance timely disclosure; that officer must be able to communicate in Japanese or English and be in charge of corporate disclosure in the home jurisdiction.[319]

d) China: Secondary Market Disclosure

China has highly codified secondary market requirements. CSRC regulations include provisions for continuous disclosure of company information through semi-annual, annual, and material event reports. Issuers must release semi-annual reports within two months after the first half of every fiscal year.

Information that companies must disclose includes: the financial reports and business situation, major litigation involving the company, the particulars of any changes in the shares or corporate bonds already issued, and any major matters submitted for consideration by the shareholders. Within four months of the end of the fiscal year, companies must submit an annual report to State Council regulators and the stock exchange. The CRSC rule stipulates the form and content of annual reports, including: summary of accounting and business statistics; overview and changes in the shareholding; a report from the directors

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[318] Dai Higashino, "Corporate Reorganization Picks up Steam in Japan, Part 1: Improved Legal Provisions", *Japan Economic Monthly* vol. 6 (November 2004) 1-9 at 4.
[319] Tokyo Stock Exchange, *Listing Guide for Foreign Companies, ibid.* at 14.

and advisors; a business report; a report on the company's financial situation; a financial statement; a report on the use of capital; and disclosure of major events.

Chinese securities law requires a company to disclose any material event that may affect the price of the stock. The law lists 11 types of material events: a major change in the business policies or scope of business; decisions regarding a major investment or capital purchase; an important contract signed by the company that may have a substantial impact on the assets, liability, rights, interests, and performance of the company; any incurrence by the company of a major debt or default on a major debt; any incurrence by the company of a major loss exceeding 10% of the net capital of the company; any major change in the external production or business conditions of the company; any change in board chair, more than 1/3 of the directors, or the manager of the company; any relatively major change in the shareholding of a 5% or more shareholder; any company decisions to reduce capital, merge, divide, dissolve the company or file for bankruptcy; and major litigation involving the company or where a court overturned a company decision.

In addition to mandatory information, the Code specifies that the issuer must disclose, in a timely fashion, all other information that may have a material effect on the decisions of shareholders and stakeholders, and shall ensure equal access to information for all securities holders.

The CSRC is responsible for overseas liaison and international cooperation in securities and futures. There are currently distinctions between Chinese-invested companies and those that do not qualify for that status under the *Law of the People's Republic of China on Wholly Foreign-owned Enterprises.* There is also a law on joint ventures and equity joint ventures, which is likely to be abolished in light of China's commitment to give equal treatment to foreign and Chinese investors when acceding to the WTO.

China has made no move towards an integrated disclosure system, concentrating on a level of codification that will enhance investor confidence in China as it becomes an increasingly important player in international capital markets. The high level of codification, if it is in place in practice, is likely to enhance market efficiency and public confidence in Chinese capital markets. However, there was insufficient information to arrive at an informed opinion on whether the disclosure system is complied with by issuers and other market participants or to determine if the requirements are bolstered by the appropriate enforcement mechanisms and resources. As the Canadian experience indicates, enforcement of disclosure violations is key to investor protection.

v. Disclosure as a Corporate Governance Tool

In all jurisdictions examined, securities regulators have entered the market for corporate governance, primarily on basis of imposing disclosure requirements, most under a "comply-or-explain" approach.

a) European Union: Corporate Governance Disclosure

The EU *Prospectus Directive* specifies that its disclosure requirements do not prevent a member state from imposing particular disclosure requirements in addition to those specified, notably regarding corporate governance.[320] The EU *Modernization Directive* on enhancing corporate governance in the EU was promulgated in 2003. Mid- and large-cap companies must provide analysis of the development and performance of their business in annual reports; describe principal risks and uncertainties, and financial and non-financial performance indicators. Legislation enacted in December 2005 imposes collective responsibility on board members for financial and other key information they publish in annual reports and requires enhanced reporting of off-balance sheet arrangements.[321] The new provisions require the issuer to publish an annual corporate governance statement, although the rules are less onerous for small and medium size enterprises.[322]

The EU *Recommendation on Independent Directors and Board Committees* is non-binding, but adopts a "comply-or-explain" model that will be fully effective June 30, 2006. It includes a requirement to disclose directors' other time commitments, and to undertake to limit the number of directorships and other professional commitments to assure proper performance of duties. The EU *Recommendation on Remuneration for Directors of Listed Companies* is also non-binding, but also adopts a "comply-or-explain" approach and is effective June 30, 2006. Under it, shareholders are to be kept informed about the company's policy on director remuneration, controls on remuneration, and specific amounts compensated, including pensions, loans and rights to shares.

The dissemination of information is a key component of the *Company Law Action Plan.* The EU is currently engaged in seeking the views of stakeholders regarding future directives on shareholder rights, including: timely and fulsome dissemination of information before general meetings; measures to enhance

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[320] EU *Prospectus Directive, supra*, note 140 at para. 15.
[321] EU *Transparency Directive, supra*, note 136 and amendments to 4th and 7th directives have liability rules and sanctions for failure to comply with accounting rules; enacted December 15, 2005; http://news.ft.com/cms/s/dc353da0-6d94-11da-a4df-0000779e23. The Parliament expressly implemented these requirements in response to the Enron and Parmalat scandals, *ibid.*
[322] *Ibid.*

proxy and electronic disclosure and voting; required disclosure by institutional investors of investment and voting policies; and voting records in specific cases.[323]

United Kingdom

In terms of examining how these initiatives are being implemented in Member States, it may be that there is some disconnect between the EU directives and how corporate governance disclosure is being regulated on the ground. In the U.K., there are a growing number of disclosure guidelines, all adopting a "comply-or-explain" approach for domestically registered companies. Non-U.K. registered companies must report annually whether they comply with the corporate governance regime of their country of incorporation and how corporate governance practice differs from the U.K. *Combined Code.* An expected Company Law reform bill is still in progress, enhancing disclosure and voting rights for beneficial shareholders, and compelling institutional shareholders to disclose how they voted.

After initially proposing a more codified governance disclosure regime, in November 2005, the government eliminated the requirement on listed companies to produce an operating and financial review (OFR), annual report on risks and opportunities, including environmental concerns. This shift in direction was met with some opposition, as many public companies had already expended the costs to tool up for the new disclosure requirements.

Most controversial is perhaps the codification of directors' duties for the first time, specifically, the scope of director liability and issue of taking account of stakeholder interest. To date, director obligations have been a matter of company law, not codified obligations. The U.K. has chosen not to implement *S-OX* 404 type obligations.

Yet under U.K. law, measures toward corporate social responsibility are to be disclosed. Listing Rule 9.8.6R(5)-(7) encourages companies to report on topics such as Corporate Social Responsibility on a voluntary basis, with voluntary guidelines in effect June 27, 2005.[324] There are a growing number of disclosure guidelines including: ABI's Disclosure Guidelines on Social Responsibility, 2001; FORGE Guidance on Corporate Social Responsibility Management and Reporting for Financial Services Sector, 2002; Business in the Community's "Indicators that Count", 2003 and PIRC's environmental reporting guidelines in Shareholder Voting Guidelines, 2005.

[323] The directive is expected 2006-8.
[324] Company non-observance could lead to compulsory reporting in 2008.

These measures towards corporate social responsibility reporting are developments that merit some consideration as Canada considers redefining the contours of a modern disclosure regime. Although the form attached to the Canadian continuous disclosure national instrument now requires issuers to disclose social, environmental and other risks, the U.K. disclosure guidelines suggest much more fulsome disclosure on social responsibility initiatives.

b) United States: Corporate Governance Disclosure

There have been extensive regulatory and policy changes to U.S. corporate governance disclosures since 1999, which to deal with comprehensively would be far beyond the scope of this report. The measures were in response to corporate scandals that were caused in part by the failure of corporate boards to exercise proper oversight. The SEC approved new corporate governance rules proposed and adopted by the New York Stock Exchange (NYSE) and NASDAQ, effective 2004. The rules required issuers listed on the exchanges to comply with specified corporate governance standards, including requirement for director independence, a written charter on corporate goals and objectives, and audit committee membership and function requirements. Listed companies were required to adopt and disclose corporate governance guidelines, including director qualification standards, director responsibilities, director continuing education, and annual performance evaluation of the board.[325]

Listed companies are also to adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or officers.

NASDAQ's corporate governance rules are similar, requiring increased board and auditor independence; strengthening the role of independent directors; implementing a code of conduct for corporate officers; and expanding the authority of the audit committee.

NYSE/NASDAQ Rules require that an audit committee satisfy the requirements of the *Sarbanes-Oxley Act*. There must be annual disclosure of any significant differences between the corporate governance practices and the NYSE/NASDAQ listing standards, prompt notification if the company becomes aware of any material non-compliance with relevant standards, and an Annual Written Affirmation with respect to the company's governance practices, and Interim Written Affirmation on each audit committee change.

[325] For a full discussion, see Condon, Anand and Sarra, *supra,* note 6 at 162-170.

E-web shareholder communication is proposed for 2007, which may allow U.S. issuers to choose to communicate with shareholders via company's website.[326]

The SEC has recently backed away from part of its *S-Ox* 404 commitment; specifically, it has delayed applying requirements for auditor certification of internal controls for non-accelerated issuers until at least July 15, 2007.[327] This has been a contested requirement, because of the costs on the issuer and the legal liability onus being placed on auditors. As discussed above, the SEC is contemplating a move away from *S-Ox* 404 rules for micro-cap and small-cap issuers and have delayed implementation dates.

The U.S. SEC released draft regulations in January 2006 on Executive Compensation Disclosure. Proposed revisions to executive compensation disclosure are aimed at improving the "total mix of information available to the marketplace".[328] The SEC acknowledged that it is for the board to determine how best to align executive compensation with corporation performance. The goal of the SEC is to ensure that investors have access to all of the compensation information they need, presented in a clear and understandable form that they can use, and hence boards need to disclose a clear explanation of how they arrived at both the amount and the measurement. The rule changes would require a new Compensation Discussion and Analysis section to replace the Compensation Committee Report and performance graph. This will provide both an obligation and an opportunity for a company to explain its compensation policies. The rule changes would also amend Form 8-K to focus current disclosure of executive compensation arrangements on unquestionably or presumptively material events. The new rules would reorganize and consolidate the related party disclosure rules and the rules regarding disclosure of director independence and other corporate governance matters. They would for the first time require that all compensation to board members be fully disclosed.

Electronic Proxy Proposal

The SEC has introduced an electronic proxy proposal, aimed at making the Internet a more efficient forum for communication with shareholders. A postcard-sized notice would apprise shareholders of the availability of their proxy materials on the Internet.[329] By going online, they could search the proxy statement for the items they want, and follow links to other, more detailed information. Shareholders will

[326] Christopher Cox, Chair of the SEC, Remarks before the Committee for Economic Development, (21 March 2006), http://www.sec.gov/news/speech/spch032106cc.htm.
[327] Section 404, Pub. L. 107-204 (2002).
[328] Christopher Cox, Chair of the SEC, *Proposed Revisions to Executive Compensation and Related Party Disclosures* (17 January 2006), http://www.sec.gov/news/speech/spch011706cc.htm at 3.
[329] Cox, *supra*, note 326.

"be able to do everything they do now with paper proxies", just, in the SEC's words "more of it, and faster and more efficiently". Investors who want paper in addition, or instead, would simply call a toll free number. The U.S. experience could be helpful to Canada's consideration of a move to an "access equal delivery" of corporate governance disclosures.

Overall, in comparison with the U.S., Canada has adopted a relatively hands-off approach to corporate governance requirements. Disclosure of governance measures are required, and more recently, there has been greater move towards a comply-or-explain approach to best practices, but there has not been the level of intervention into corporate governance structure and practice that has been implemented in the U.S.. If corporate governance disclosure is to be used as a signalling device, then mandatory full, true and plain disclosure of governance practice could be sufficient to meet the needs of market participants.

c) Australia: Corporate Governance Disclosure

The Australian Stock Exchange (ASX) published rules on disclosure of corporate governance practices in 2001, specifying that its role is to encourage corporate governance disclosure, not require particular practices.[330] It requires disclosure of the main corporate governance practices of the entity. It did not have express governance rules, but referred issuers to best practice guides in the profession, including having a mix of executive and non-executive directors; oversight of preparation of financial statements, internal controls and independence of the issuer's auditors; review of compensation practices; and resources available to directors in carrying out their duties.[331] It suggested that boards should identify areas of significant business risk and to manage those risks, and put in place appropriate ethical standards. The ASX did not prescribe any particular practices, requiring only disclosure of corporate governance practices.

A shift occurred when the ASX Corporate Governance Council published *Principles of Good Corporate Governance and Best Practice Recommendations* in 2003.[332] The principles recognize that one size does not fit all. The principles include that an issuer should: lay solid foundations for management and oversight; structure the board to add value; promote ethical and responsible decision making; safeguard integrity in financial reporting; make timely and balanced disclosure; respect the rights of shareholders;

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330 ASX, *Guidance Note 9, Disclosure of Corporate Governance Practices: Listing Rule 4.10*.
331 For example, the Working Group on Corporate Practices and Conduct (the Bosch Committee), *Corporate Practices and Conduct*, November 1998; Australian Investment Managers Association, *Corporate Governance: A Guide for Investment Managers and Corporations,* July 1997.
332 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, http://www.asx.com/au/corporategovernance.

recognize and manage risk; encourage enhanced performance; remunerate fairly and responsibly; and recognize the legitimate interests of stakeholders.[333] It suggests how to achieve these best practices. The ASX also issued a Guidance Note to assist issuers in preparation of reports on their corporate governance practices under listing rule 4.10.2.[334] The ASX and the ASIC have expressly not adopted *S-Ox* 404 type reporting.

In 2003, the ASX also introduced listing rule amendments to enhance compliance with corporate governance best practice and to mandate audit committees for the top 500 companies in the All Ordinaries Index.[335] This moved corporate disclosure to a "comply-or-explain" standard in Australia. Under listing rule 4.10.3, commencing 2004, an issuer must include in its annual report a statement disclosing the extent to which the entity has followed the best practice recommendations set by the ASX Corporate Governance Council during the reporting period, and identify all recommendations that it has not followed and give reasons for not following them.[336] Listing rule 12.7 specifies that an entity that is included in the S&P All Ordinaries Index at the beginning of its fiscal year must have an audit committee; and its composition, operation and responsibilities must comply with the best practice recommendations set by the ASX Corporate Governance Council.[337] Hence, these are mandatory requirements effective for the first financial year commencing after January 1, 2003.

CLERP 9 strengthened disclosure in respect of corporate governance practice. Where directors include additional information necessary to give a true and fair view of the company's financial position and performance, the directors' report must set out the directors' reasons for forming the opinion that the inclusion of additional information was necessary and specify where the additional information can be found in the financial report. The auditor's report must include a statement on whether the inclusion of the additional information was necessary to give the true and fair view.[338]

There is a requirement of remuneration disclosure, specifically, CLERP 9 amended section 300A of the *Corporations Act* to require listed companies to provide details of remuneration paid to directors,

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[333] *Ibid.* at 9.
[334] ASX, *Guidance Note 9A, Corporate Governance- ASX Corporate Governance Council- Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003.
[335] *Ibid.* at 1.
[336] The ASX Corporate Governance Council was convened in 2002 to develop best practice recommendations.
[337] Listing rule 12.7, introduced 1.1.2003, http://www.asx.com/au/corporategovernance.
[338] On enacting CLERP 9, the Senate and Government agreed

specifically the five highest paid company executives, and the five highest paid consolidated group executives.[339]

The ASIC released compulsory guidelines in December 2003 that work with the *Financial Services Reform Act, 2001* to require disclosure of how social, environmental and ethical considerations inform investment decisions. The ASIC are non-prescriptive, and do not define what constitutes an environmental or social consideration, nor how they should be taken into account. One report analyzing the requirements has observed that the guidelines effectively allow issuers to determine the quantity, format and accuracy of SRI disclosure, and argue that because of that, the legislative goals of transparency, accuracy, comprehensibility and comparability are not being met.[340]

The ASIC has expressly stated that its role is to regulate equity capital markets to order to promote confidence and integrity that encourage domestic and foreign investment, but that it also has a role in protecting consumers to promote market integrity and confidence.[341] At the same time, investors have been granted self-help remedies in the form of class action suits, and the ASIC co-operates in access to its records and through *amicus curiae* or intervener participation in hearings, or in limited cases, commencing an action.[342] The ASIC engages in a cost/benefit analysis in terms of uses of its limited resources to initiative or participate in such proceedings, based on its regulatory objectives.

The ASX is expressly attempting to instil a culture of compliance in respect of disclosure, through active dialogue with its listed companies; intervention to require disclosure in appropriate circumstances; requiring officer undertakings in relation to specific disclosure requirements; disclosing to the market particular concerns; and suspension of trading where the ASX concludes that the market may be trading on an uninformed basis.[343]

[339] http://www.mallesons.com/search-hithighlight.cfm?hitURL=/public.
[340] W. Baue, SocialFunds.com, citing a report by A. George, N. Edgerton and T. Berry, Institute for Sustainable Futures.
[341] ASIC, *Corporate Wrongdoing: ASIC's Enforcement Role*, (2 December 2005) at 4.
[342] Section 50, *ASIC Act;* s. 1330 *Corporations Act.* For serious misconduct, criminal action or injunctive relief may be pursued.
[343] ASX, *Enhanced Disclosure- Executive Summary* at 2.

d) Japan: Corporate Governance Disclosure

Under Japanese securities law, there is now required disclosure of governance structures that ensure accountability for disclosures made in annual and semi-annual reports.[344] Recent amendments to the *Commercial Code* enacted in May 2002 that took effect on April 1, 2003 were the most significant changes in 50 years.[345] The 2002 Amendments are wide-ranging, and included provisions that address corporate structure, mechanics and corporate governance.[346] Many amendments are a shift away from the main characteristics of the traditional Japanese corporate environment including bank-centered capital markets, *keiretsu*-controlled stock ownership patterns and management and control of companies by close groups of insiders. The 2002 Amendments allow companies to choose between the traditional Japanese governance form where the company is run by the board of directors with oversight from statutory auditors, or a U.S. style "committee system" where committees of the board comprised of outside directors are given responsibility for reviewing the board.[347]

Other amendments to the *Commercial Code* enhanced corporate governance disclosure requirements, clarifying the responsibilities of executive officers and the auditing system; introducing systems for establishing corporate committees; and moving shareholder communication to paperless business documents and digital voting at shareholder meetings. At the same time as offering a choice of corporate governance structure, the requirements to disclose that choice have been enhanced. Issuers must also disclose their basic ideas and implementation of relevant policies for better corporate governance in addition to business plan and finalized business results.[348] Effective 2003, Japanese listed companies are required to report on condition of corporate governance, including corporate governance systems, interests that outside directors and auditors have in the company, and measures to fulfill governance standards in preceding year.

The Ministry of Justice enacted a new Japanese corporate law in July of 2005 that will come into force late in 2006. The new corporate law consolidates all existing provisions relating to corporations into one statute. It also combines the two existing corporate governance options, the traditional Japanese option

[344] Annual Report (*Yukashoken-Hokokusho*) and Semi-Annual Report (*Hanki-Hokokusho*), Japan *Securities and Exchange Law.*
[345] Since the war, the *Commercial Code* has been amended 22 times. For a chart summarizing all of the corporate changes to the Commercial Code and other relevant Japanese legislation see, Dai Higashino, *supra,* note 318, at 3.
[346] The amendments also allow stock acquisition rights, which made poison pills possible. *Ibid.*
[347] Hiroyuki Itami, "Revision of the Commercial Code and the Reform of Japanese Corporate Governance" http://www.jil.go.jp/english/documents/JLR05_itami.pdf at 4.
[348] *Security Listing Regulations and Supplementary Rules to Security Listing Regulations,* 10 December 2003, at Part III (6), Disclosure Requirements after Listing.

and the U.S. committee style option, into one flexible corporate form, and allows foreign companies to purchase Japanese companies through a share exchange or swap, although this provision will not come into effect for some time.

e) China: Corporate Governance Disclosure

In China, issuers must disclose information regarding corporate governance, including board structure, and evaluation of directors, board of directors and supervisory board. There is also required disclosure of issuance of independent opinions of independent directors; composition and work of specialized committees; and reports on the gap between issuer's corporate governance and the Code. The issuer must disclose any plans for improvement of corporate governance. There are relatively recent requirements to disclose controlling shareholder interest.[349] A new court has now been constituted to deal with major financial and securities law cases following the newly amended company law, including governance disclosure violations.

There were two difficulties in examining China's disclosure regime. First, there are language barriers, in terms of direct access to disclosure requirements. The second is cultural, in that often matters that are codified in China in respect of corporate, securities and commercial matters, are not reflective of practice on the ground. In the timeframe for this report, the author was not able to confidently make observations as to what is currently occurring on the ground regarding corporate governance as an effective signalling device.

9. <u>Conclusion</u>

This is a report about disclosure, as a goal and as a regulatory instrument. Many different options have been utilized in different jurisdictions in determining the amount of disclosure required. Disclosure is both a public policy objective and a public policy instrument in current Canadian securities regulation. As a public policy objective, full, true and plain disclosure advances the objectives of the legislation; specifically, the protection of investors, the promotion of efficient capital markets and public confidence in capital markets. As a policy instrument, disclosure reduces transaction costs, measures compliance and signals the quality of corporate governance of the issuer.

Domestically, there are signs of convergence in some areas of securities law, through the establishment of national instruments and policies, the implementation of MRRS, and the recent passport system.

[349] Effective, 2001.

Convergence in domestic disclosure requirements will reduce the cost of capital, enhance efficiency of Canadian capital markets and meet the public policy objectives of the Canadian disclosure regime.

There are multiple challenges to modernizing disclosure in the Canadian system. Issuers, intermediaries and other market participants want certainty, timeliness and cost effectiveness in disclosure requirements. There is a need to reduce fragmentation of information across multiple documents. Materiality continues to be problematic in terms of definitions under material change and material fact reporting, and it may be timely to redefine materiality to create one national disclosure standard.

Deference to business judgments regarding materiality needs to be balanced with the need for statutory compliance. A third challenge is the lack of integration between the primary and secondary markets in terms of disclosure requirements, and consequent issues of clarity and accessibility; modernization of securities legislation must seriously consider an integrated, electronic disclosure regime.

With the increased involvement of retail investors in the market, both directly through online facilities and through managed investment funds, the nature of investor interests lies more along a continuum of interest, information and sophistication, rather than a two-tier dichotomy between retail and institutional investors. Institutional investors also run along that continuum in that while they are sophisticated investors, they have different interests, time horizons and priorities in their market activity. The disclosure regime must recognize the diversity and complexity of investor interests along this continuum.

There are three options to modernization disclosure. One possible option is to maintain the *status quo* for a period in order for the market to gain some experience with current harmonization efforts under national instruments, e.g. NI 51-102 *Continuous Disclosure* and NI 44-101 *Short-Form Prospectus Distributions*, and recently announced changes to MI 52-111 *Reporting on Internal Control over Financial Reporting.* This option does not, however, address the serious fragmentation of information issue.

Another option is to maintain the current disclosure framework, and concentrate on mechanisms to make disclosures more accessible and meaningful for investors, through devising a framework for web-based delivery and locating disclosures in one place on a "one-click full access" basis. Securities regulators should consider how to move disclosure into a system that takes full advantage of technological developments. It is timely to consider how an "access equals delivery" model could be implemented, and how the system could be fashioned to ensure that investors are fully informed based on materiality requirements, in as fully, accessibly and as timely a manner as possible. However, the current fragmentation of electronic disclosure to a barrier to accessible disclosure and there is a need to centralize information. Hyperlinks, which can enhance disclosure, also can create particulars risks that need to be addressed in any move to a fully electronic system. The new U.S. XBRL electronic platform should be considered as a possible disclosure enhancing tool for the Canadian capital market.

A third option for a modernized securities system is to locate disclosure in one "living" integrated market disclosure document that investors can access at any point in the life cycle of the issuer, whether it is making an offer of securities to the market or meeting its continuous disclosure obligations, as set out in some detail in Part 7 of this report. There may be a continued role for underwriters as gatekeepers in an integrated market disclosure system. There must also be enhanced investor education regarding disclosure and its benefits, risks and limits.

Disclosure documents should clearly identify their purpose and provide full true and plain information in an accessible form. Full disclosure requires a level of completeness and sufficiency in quantity and degree where that information is material, such that investors can make informed decisions. True denotes a level of correctness and honesty. Plain includes clear, simple and readily understood. While plain language may be necessary for unsophisticated retail investors or those investors without the time or resources to analyze all disclosure documents, disclosure requirements must nevertheless continue to provide analysts, institutional investors, regulators and other market participants with the level of detail that they require to make informed judgments about their investment advice or regulatory approval.

While the policy instruments vary across the five other jurisdictions examined in this report, the goals of the various disclosure regimes are almost identical. There are no jurisdictions of those studied that yet have implemented an integrated disclosure system, although recent disclosure initiatives have set some jurisdictions along that path. Canada could be a leading force in determining the direction of integrated market disclosure both domestically and internationally, if it determines that this is a priority for modernization of the securities regime.

There are features in the disclosure systems of the comparative jurisdictions that should be considered as Canada moves toward reform of its disclosure regime, including: mandatory summary sheets on disclosure documents; market integrity issues in respect of electronic disclosure; the relative benefits and risk of market impact versus reasonable investor tests for material disclosure; and early moves towards more integrated primary and secondary market disclosure.

Internationally, there is little disagreement about the goals or purposes of disclosure. It may be that the way forward for both Canada in its modernization of securities regulation and for regulators globally is to try to devise a rubric, using measurable criteria, to describe when information enhances or detracts from market efficiency, investor protection and/or public confidence in the market. Once measurable criteria are developed, policy makers may be able to gather useful data on which to base an analysis of the current regulatory system and move reform forward from a clash of concepts towards an effort to achieve a common goal based on empirical information about the impact of the current regime. In the interim however, there are positive signs of convergence.

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