

Research Study

**Importing the e-World into Canadian
Securities Regulation**

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June 20, 2006

**Commissioned by the
Task Force to Modernize Securities Legislation in Canada**

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Acknowledgements

The author is grateful for comments on a previous draft by Ed Waitzer, Gloria Stromberg, Jeff Elliott, Poonom Puri and the participants of the 'Importing the E-World' Task Force Roundtable at University of Toronto on 1 February 2006. She is indebted to Sophie Riley for research assistance and to Stikeman Elliott for much assistance with the substance of Canadian securities and mutual funds regulation.

1. Executive Summary

The thrust of the proposals in this report is to identify a disclosure scheme that builds on existing developments, and takes advantage of the potential for electronic transmission of securities information. It particularly uses the ability of Internet communication to transmit information in a way that responds to user needs, setting out a graduated scheme that caters to the spectrum of investors from retail to sophisticated or professional. The proposal specifically takes account of problems with the existing regulation of electronic delivery and wider developments in the nature of securities disclosure. It also builds on what we know about how well investors use current disclosure documents in investment decision-making, and levels of investor financial literacy. It recommends that a three-page foundational document and a ten-page document containing issuer and investment specific detail, along with access to continuing disclosure, substitute for the existing prospectus.

2. Summary of Recommendations

Recommendation #1: Disclosure should be made on a graduated basis, formatted according to user needs so that investors can choose the level of volume and technicality they desire.

Recommendation #2: It should be compulsory to give all investors some short and salient facts about an investment - price, risk levels, fees and charges, basic terms of the investment.

Recommendation #3: If greater reliance is to be placed on electronic transmission of securities information in Canada, SEDAR must be improved to make it more reliable and user-friendly. It must operate in a manner that ensures it provides easy access to information rather than creating barriers or obstacles.

Recommendation #4: Reconsideration should be given to the requirement of express consent to electronic delivery, so long as access to and integrity of the delivered document is assured (e.g. because the document is very short).

Recommendation #5: A foundational disclosure document of three pages in standard format should be disseminated to all investors by intermediaries in the selling process. The intermediaries will not be taken to have fulfilled their suitability obligations if they do not bring this document to the attention of the investors. The third page of the document should be an application form which the investor must sign or submit using a PIN.

Recommendation #6: A document containing issuer- and investment-specific information of 10 pages in standard format should be made available to by the intermediary to the investor. A self-directed investor would be alerted to it by the URL or hyperlink on the foundational document, which must be used to apply for the securities.

Recommendation #7: The foundational disclosure document and the document containing issuer- and investment-specific information should bear URLs or hyperlinks to locations such as SEDAR where the issuer's continuous disclosure record is available.

3. Introduction

The Task Force to Modernize Securities Legislation in Canada has as one of its premier interests an enquiry into regulatory burden.¹ The possibilities of electronic document transmission for the reduction of regulatory burden are still a matter for research and reflection. It is the purpose of this report to explore further the potential of the “E-world” to reduce regulatory burden and increase regulatory effectiveness in the area of electronic document delivery. As the project proposal indicates, this study has been undertaken against the background of traditional principles of securities regulation: investor protection and equality of access to information.

The proposals in this report set out a disclosure scheme that builds on existing developments and takes advantage of the potential for electronic transmission of securities information. It particularly uses the ability of Internet communication to transmit information in a way that responds to user needs, setting out a graduated scheme that caters for the spectrum of investors from retail to sophisticated or professional. The proposal specifically takes account of problems with the existing regulation of electronic delivery and wider developments in the nature of securities disclosure. It also builds on what we know about how well investors use current disclosure documents in investment decision-making, and levels of investor financial literacy.

The report considers three main securities relationships that mandate disclosure: issuer filings with the System for Electronic Document Analysis and Retrieval (SEDAR),² issuer delivery to security holders, and broker delivery of securities information to their customers. The report also makes and works through the consequences of the distinction between delivery to existing security holders and attracting new investors to the company. The current regulation which requires express consent to electronic delivery by security holders *and* potential security holders, is a particularly stiff barrier to electronic transmission of prospectuses and other selling material. This stems from the difficulty and cost of actually soliciting consents, especially in the case of potential investors who might never take up the investment.

The report is divided into eight parts. After the executive summary and table of recommendations and this introduction, Part 4 considers the purposes and limits to disclosure. It questions whether the current requirements for electronic delivery really support the purposes of disclosure, or tend to frustrate them.

¹ Investment Dealers Association of Canada, ‘IDA Launches the Task Force to Modernize Securities Legislation in Canada’ News Release, 27 June, 2005.

² The System for Electronic Analysis and Document Retrieval. SEDAR’s website is available at <http://www.sedar.com/> See text surrounding notes 95 to 108 for a more detailed overview of SEDAR.

Part 5 outlines some of the technical issues that condition how electronic documents can be transmitted. It draws attention to some of the dangers of electronic securities information transmission, which must be weighed against the undeniable benefits which electronic technology provides. Part 6 looks at the current Canadian rules which govern delivery of securities documents, and looks in detail at a number of central examples. So, for example, prospectus delivery obligations have been chosen and so have Annual Information Forms. Proxy forms and information circulars are also considered, and delivery of confirmations to customers by brokers. Once the analysis of these obligations has been undertaken, insights may be applied to other document delivery obligations of which there are a great many. This Part ends with a policy discussion of the difficulties of the current legislation governing electronic delivery, in particular the requirement to obtain express consent to such delivery from intended recipients.

Part 7 sets out four alternatives to electronic delivery that the Task Force may wish to consider. Having considered the advantages and disadvantages of Extensible Business Reporting Language (XBRL), the possibilities of legislating for a 'duty to browse' by security holders, and canvassing the access-equals-delivery option, the report settles on what it calls the graduated approach to securities information transmission. As indicated in the synopsis, this recommends a three-page foundational document and a ten-page document containing issuer and investment specific detail, along with access to continuing disclosure in substitute for the existing prospectus requirements. To this could be added in time, disclosure in XBRL, making a spectrum of good and timely disclosure which addresses user needs from retail investors to professional investors. Part 8 concludes the report.

4. The Purposes and Limits of Disclosure

One approach to rethinking the transmission of securities information is to think about the purposes of disclosure. This must be conditioned by the functional limits of disclosure: there is no point for example, in disclosing to retail investors information that levels of investor education show will not be used, and may simply serve to confuse. In thinking about the purposes and limits of disclosure, it is centrally important to keep the audience for particular types of disclosure in mind. Before considering the purposes of disclosure, it is necessary to give a short précis of some relevant recent developments. An important development, which has been greatly assisted by the Internet, is the growth of continuing disclosure.³ Instead of disclosure being limited to transactions (e.g. securities issues prompting a prospectus), listed companies are now required to keep the market informed through number of regular filings with the regulator, which is made available to the public through SEDAR and postings on the company's website. In addition to these regular disclosures, material events or changes in the company's business conditions or plans must also be disclosed. An important feature of continuing disclosure, is that it is not always delivered to investors - rather, it is often simply made available by a posting on the Internet, often with no notification to investors either. This point is elaborated further below.⁴

i. The Position in the U.S. and Canada

In Canada and the U.S. some specific proposals have been made for the reform of disclosure practices, as a result of the greater reliance on continuing disclosure, and the availability of information over the Internet. In British Columbia, the proposed Continuous Market Access System would require public issuers that qualified to keep their public disclosure 'evergreen' through a continuing disclosure system.⁵ The proposal is that they may issue securities at any time with only a press announcement, and that civil liability would attach to the continuing disclosure record, and to any documents used in the marketing and sale of the securities. This proposed system has been the subject of considerable analysis⁶, but as yet has

³ M Condon, A Anand, J Sarra *Securities law in Canada : cases and commentary*. Toronto : Emond M, 2005, Chapter 6.

⁴ See text surrounding notes 96 to 101.

⁵ Note also that there may be implications for the record keeping and auditing processes of organizations that make continuous disclosure – e.g. should the reporting cycle become shorter, or should auditing be evergreen too? Fisher, Oyelere & Laswad 'Corporate Reporting on the Internet' (2004) 19(3) *Managerial Auditing Journal* 412-39 at 26.

⁶ For example, G Stromberg Regulatory Strategies for the Mid-90s – Recommendations for Regulating Investment Funds in Canada, prepared for the Canadian Securities, January 1995. Available http://www.osc.gov.on.ca/About/Publications/op_stromberg.jsp; G Stromberg Investment Funds in Canada and Consumer Protection, Office of Consumer Affairs Canada 1998. Available from <http://strategis.ic.gc.ca/oca/crd/document.do?id=801&lang=eng>

not been implemented.⁷

Under the 2005 U.S. changes, ‘seasoned’ and ‘well known’ issuers (i.e. those with a qualifying disclosure record), and their agents may use ‘free-writing prospectuses’ to market and sell securities. ‘Seasoned’ and ‘well known’ issuers have a considerable public record of disclosure, an important element of which is continuing disclosure. U.S. issuers in these categories no longer have to ensure that investors have a statutory prospectus in their hands, prior to or contemporaneously with the free-writing material. They must simply include a legend on their selling material that there is a statutory prospectus available, and include the electronic address in the Electronic Data-Gathering, Analysis, and Retrieval (EDGAR),⁸ or the URL for another website where it may be accessed.⁹ Investors are presumed to have access to the Internet and the obligation to transmit a final prospectus may be satisfied by filing the final prospectus with the Securities Exchange Commission (SEC), and its subsequent availability to investors through the SEC’s EDGAR database.¹⁰

There is now a body of both anecdotal and research evidence that casts doubt on the degree to which investors read prospectuses, and therefore how valuable they are in investment decision-making. While anecdotal evidence that suggests very low readership rates indeed abounds,¹¹ it is rather harder to find good research on this question.¹²

⁷ See History of the BC 2004 Securities Regulation at: <http://www.bpsc.bc.ca/instruments.asp?id=1894>. Also Securities Act 2004 (BC) and New Concepts for Securities Regulation (2002) at <http://www.bpsc.bc.ca/instruments.asp?id=1894>

⁸ Electronic Data Gathering, Analysis, and Retrieval system where electronic lodgement of forms required to be lodged with the SEC may be made. Website <http://www.sec.gov/edgar.shtml>

⁹ H M Friedman *Securities Regulation in Cyberspace* (Aspen , 3rd Ed + 2006 Suppl) Ch2.

¹⁰ For example, rule 172 (para 230.172), Securities and Exchange Commission, Securities Offering Reform; Final Rule, 17 CFR Parts 200, 228, 229 et el (3 August 2005). Release nos. 33-8591; 34-52056; IC-26993; FR-75, International Series Release No 1294 and File No. S7-38-04. Available at <http://www.sec.gov/rules/final/33-8591fr.pdf> See page 44808 of the Federal Register.

¹¹ See, for instance, B Kanner *Are You Normal About Money* which indicates that 72% of investors do not read prospectuses from mutual funds. 1995 St Martin’s Press. USA; that only 1% of investors read prospectuses is suggested by J Waggoner and C Dugas “Bite the bullet, read the fund prospectus – it will pay off,” *USA Today* December 28, 2003, http://findarticles.com/p/articles/mi_kmusa/is_200312/

¹² Two of these, the 1981 report of Ruth Hines and the 1987 study undertaken in the United States by SRI International (SRI) are referred to in R McKenzie ““Jumping the Gun” – An Examination of the Law Relating to Pre-prospectus Advertising of Securities Issues in Australia” *Murdoch University Electronic Journal of Law* Volume 1, Number 1 (1993) at 4. See also Joint Forum Consultation Paper 81-403: Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds. Summary of Comments and Responses. Prepared by the Canadian Securities Administrators and the Canadian Council of Insurance Regulators 2003 at 7-8. Available at <http://www.jointforum.ca/JF-WWWSite/consultation.htm>

In 1996, the Investment Company Institute (ICI),¹³ a United States-based association founded in 1940, undertook a report to the U.S. Securities and Exchange Commission on profile prospectuses.¹⁴ Part of that report comprised an evaluation on whether traditional section 10(a) prospectuses¹⁵ provided useful and meaningful information to investors. The research methodology consisted of a survey of 1,000 randomly selected shareholders as well as information gathered by fund groups from customers and financial advisors. These results revealed that approximately one-half of mutual fund investors had not read the prospectus prior to investing in the fund.¹⁶ Although this figure is significantly lower than information obtained from unsubstantiated and anecdotal sources it still represents a considerable portion of the investing public. The reasons for this are varied and range from the amount of information in the reports, the lack of standardization that makes comparisons difficult, to the complexity of the information.¹⁷ Also, these reports reveal that investors genuinely want to read the material, but are defeated by the presentation. Research involving proxy statements and annual reports reveal very similar trends.¹⁸

ii. The Position in Australia

One Australian study¹⁹ of the practices of both investors and their professional advisors, found that the vast majority of respondents read a prospectus for over 30 minutes²⁰ and over half the individual investors who responded "spent between 30 minutes and an hour reading the prospectus for their most recent investment".²¹ The picture seems to be very similar whether the investor is acquiring shares directly or investing indirectly through a managed fund²² (a mutual fund in Canada). Only 36% of the respondents

¹³ Investment Company Institute has a membership consisting of mutual funds, closed-end funds and unit investment trusts. ICI is engaged in promoting the interests of mutual funds whilst at the same time fostering the interests of shareholders. See website at http://www.ici.org/about_ici.html

¹⁴ Investment Company Institute *The Profile Prospectus: An Assessment by Mutual Fund Shareholders*. Volume 1 Institute Research, the Investment Company Institute 1996. A profile prospectus is an abridged and easier to understand version of the traditional full prospectus and is permissible under section 10(b) of the Securities Act 1933 (USA). Available <http://www.sec.gov/about/laws.shtml#seact1933>

¹⁵ This refers to section 10(a) of the Securities Act 1933 that sets out the requirements for disclosure in a prospectus. Available <http://www.sec.gov/about/laws.shtml#seact1933>

¹⁶ See Summary of the Research Findings of *The Profile Prospectus: An Assessment by Mutual Fund Shareholders* available at www.ici.org/shareholders/dec/rpt_profprspctus3.pdf at 2.

¹⁷ Joint Forum Consultation Paper above note 12 at pages 10-14.

¹⁸ R Hines, "Are Annual Reports Used by Shareholders?", *The Chartered Accountant in Australia*, March 1981, 48-52; SRI International, *Investor Information Needs and the Annual Report*, Financial Executives Research Foundation, Morristown (N.J.), 1987.

¹⁹ I Ramsay 'Use of Prospectuses by Investors and Professional Advisors' (Centre for Corporate Law and Securities Regulation, 2003). Available at <http://cclsr.law.unimelb.edu.au/research-papers/Monograph%20Series/Australian%20Prospectus%20Survey.pdf>

²⁰ Ibid at 21.

²¹ Ibid at p2.

²² Ibid at 48.

thought that prospectuses gave them sufficient information to make an investment decision, and 56% thought that prospectuses are not easy to understand.²³ “They have most difficulty with legal or technical jargon. They also find prospectuses too detailed and repetitive and also have difficulty with the section dealing with financial matters. 66% of respondents think that prospectuses are too long,²⁴ 52% of respondents do not find it easy to find the information they want in a prospectus. Suggested improvements are to summarize key points, simplify and clarify the contents, use less jargon, and make the prospectus more concise”.²⁵ The perceptions of financial advisors on similar questions make an interesting contrast: “85% of respondents found that clients have difficulty understanding prospectuses, finding them too long, too detailed – and too full of legal or technical jargon. Most responses indicated that clients did not want to read or cannot understand, a prospectus, and rely on their advisors to describe and interpret the investment”.²⁶ The majority of advisors thought that the role of the prospectus in the advisory process is both ‘very little’ and mostly a back-up to the advisor. Eighty-three percent of advisors believe that simpler prospectuses would be beneficial.²⁷

This study is in line with the results of the North American research outlined above. Like the others, it does not show that an overwhelming majority of individual investors do not read prospectuses, as is often suggested. Rather the reverse is true, though most of the investor respondents were members of the Australian Shareholder’s Association and likely a more-than-usually motivated group. The vast majority are reported to have spent more than a trivial amount of time reading the prospectus. It is however clear, that many investors find the way prospectus information is presented as less than useful and that is the perception of their advisors as well. It is also clear from the study that other sources of information (e.g. newspapers, investment magazines, brokers) are at least as, if not more important.²⁸ The development of continuing disclosure and the indifferent influence of prospectuses suggest that we might now look at the purposes and limitations of disclosure in a changing light.

iii. Disclosure and the Efficient Capital Markets Hypothesis (ECMH).

There are some purposes of disclosure which appear directed more at the condition of the market, than at the people and organizations making decisions within it. The Efficient Capital Markets Hypothesis (ECMH) is

²³ Ibid at 3.

²⁴ Ibid at 3.

²⁵ Ibid at 3.

²⁶ Ibid at 4.

²⁷ Ibid at 4.

²⁸ Ibid at 1.

probably the most influential single theoretical idea on role of information in financial markets. The central idea of the ECMH as Jennings et al put it is that:²⁹

“The central and least disputed claim of the ECMH is that available information about securities traded in the principal securities markets is impounded into stock prices with sufficient speed that even sophisticated investors cannot systematically profit by trading on newly available information...a market is efficient with respect to specific information if prices act as if everyone knows the information.”

The market rapidly digests all information as soon as it becomes available, and impounds this into the price of the investment. In other words, the price of an investment quickly (in ECMH jargon, efficiently), reflects all the information that is known about an investment. Efficient markets are thought to allocate capital in an optimal fashion; that is, in a way that best promotes overall welfare.

From the ECMH perspective there is very little to be gained by an individual investor spending time and energy on securities research and analysis; that is, on financial information-seeking. This is because the mechanisms of the market disperse new information so quickly, and the price adjusts accordingly. In theory this leaves no mispricing lags from which investors can develop strategies which allow them to make consistent profits that are abnormal compared to the performance of the market as a whole. Some adherents even go so far as to assert that mandatory disclosure rules are unnecessary because there are sufficient market incentives on issuers to make accurate, complete and timely disclosure without legal compulsion.³⁰ In short, adherents of the EMH argue that prospectus disclosure is redundant for professionals because it largely replicates information already in the market, and useless for retail investors whose trading behaviour cannot change the price anyway.

Although disclosure to promote informational efficiency and the optimal allocation of capital appears as a “free-standing” purpose of disclosure, it is closely related to other purposes. It feeds from them, and in turn feeds into them. So, another important purpose of disclosure - inducing and maintaining public confidence in securities markets – helps to encourage the disclosure, analysis and trading which allows

²⁹ R. Jennings, H.Marsh, J.Coffee and J. Seligman *Securities Regulation Cases and Materials* (Foundation Press, 1998) at 239.

³⁰ F. H. Easterbrook and D. R. Fishel, *The Economic Structure of Corporate Law* (1991) 286-290.

price discovery and makes markets efficient. Where there is no public confidence issuers, analysts and investors will not participate, or not as readily.³¹

Inducing and maintaining public confidence is an umbrella description for a cluster of other purposes of disclosure. Reducing asymmetry of information between issuers and investors helps to promote public confidence. In theory at least, reducing the difference in what issuers and investors know about a security should reduce opportunities for misleading and deceptive conduct and better protect investors. Good disclosure should also promote equality of information between investors (or at least access to it), augmenting a sense of fairness between investors. The equality purpose supports the extension to as many people as possible, of good quality and timely disclosure. All these are well-understood purposes of disclosure, and if realized should in theory induce improved investor decision-making, and feedback to the quality of market efficiency.

The longer we experience disclosure as a technique of financial regulation, the more we know about the limits on its effectiveness. That is not to suggest it should not be relied upon: on the contrary, nothing convincing has appeared on the regulatory landscape to replace it, and the purposes of disclosure are still valid. But it does mean that we are able to be realistic about our ability to realize fully those purposes. So it is unrealistic to expect that the reduction of information asymmetry through disclosure will necessarily protect from misleading and deceptive conduct those investors who command only a low level of financial literacy. Similarly the extension to such investors of equality of access to information may be counter productive to good investor decisions, if they are "snowed" and confused or just plain turned off disclosed material by its volume and technicality.

The response to these points has traditionally been that retail investors who lack financial literacy should use financial advisors. Advisors are able to analyze both the disclosed information and the investor's own circumstances, and recommend the most suitable product, as well as seek best execution (i.e. acquire the security in the market where it is offered on the most advantageous terms). But this response is not as compelling as it once was. For a start, a little under half of retail investors now act without an advisor,³² often investing online. This group will grow.

³¹ Much of what has been written in the period after the crash of Enron (where financial disclosure was defective) has been analysis of how to restore public confidence in financial markets.

³² Consumers Council of Canada 'A Study of Ontario Consumers' Investment Education Needs' done for the Ontario Securities Commission (February 2002), p31 (presentation on file with author).

It is at this point that there are a number of alternatives to respond to the question, “what is the purpose or the future of disclosure to a retail investor?” Focusing on this question assumes, that for wholesale and sophisticated investors, the purposes of disclosure are broadly achieved. The first alternative is to argue that another purpose of disclosure that is sometimes discussed – governmental scrutiny of disclosure – should have a greater role. The argument is that there should be a greater scrutiny by the regulator of disclosure made to retail investors. The more extreme version of this argument is that there should be a return (or partial return) to merit regulation, which involved the regulator considering and approving both the disclosure and the terms of the issue of an investment.³³ While there may be some room for policy of this type in relation to specifically retail investments such as mutual funds, it is unlikely to win supporters in relation to disclosure made with respect to reporting issuers where the pool of investors is more diverse.

iv. Disclosure and Behavioural Economics

One response to the question of what to do about disclosure to retail investors, is to argue that while issuers must make disclosure they have no responsibility to respond to investor needs, and that even if they did, it would make no difference. One interpretation of the insights of behavioural economics, an area of research that has found a counterpart in securities regulation, suggests this line of argument. There are several cognitive biases that cause investors to lose money and seem to be amplified by online investing.³⁴

Research shows that investors have a number of biases such as overconfidence, a tendency to overvalue stocks they own, and hold to hold those stocks too long in a falling market.³⁵ They also tend to interpret past investment successes as disproportionately due to their own savvy, rather than overall market conditions. Recent insights from investor psychology show that, “after going online, investors trade more actively, more speculatively, and less profitably than before” due to overconfidence.³⁶ Further, there seems to be a tendency in retail investors to “follow

³³ H M Makens, ‘Who Speaks for the Investors? An Evaluation of the Assault on Merit Regulation’ 13 *U Balt L Rev* 435 *passim* (1982); RL Knauss ‘A Reappraisal of the Role of Disclosure’ 62 *Mich L Rev* 607 at 615 (1964).

³⁴ R. Shiller and J. Pound ‘Survey Evidence on Diffusion of Interest and Information Among Investors’ (1989) *Journal of Economic Behaviour and Organisation* 12, 47-66. This is now extended to online investing, see B M Barber and T “Trading is Hazardous to your Wealth: The Common Stock Performance of Individual Investors”, (2000) 55 *Journal of Finance* 77; B M Barber and T Odean “The Internet and the Investor” (2001) 15(1) *Journal of Economic Perspectives* 41-54; B M Barber and T Odean (2002) ‘Online Investors: Do the Slow Die First?’ *The Review of Financial Studies* (2002) 15(2) 455, 455-487.

³⁵ D Langevoort, ‘Taming the Animal Spirits of the Stock Market: A Behavioural Approach to Securities Regulation’ (15 April 2002) Berkley Olin Program in Law & Economics, Working Paper Series, Paper 64. <http://repositories.cdlib.org/blewp/art64> and now published at 97 *Nw. U.L.Rev* 135 (2002-2003).

³⁶ Above note 34 B M Barber and T Odean (2000) at 73; B M Barber and T Odean (2002) at 455-487.

the herd” in hot markets and to trade on little or no new information, causing price volatility and market movements that theories such as the efficient market hypothesis cannot explain.

Given that research evidence shows that many investors do attempt to read prospectuses, the most responsible reaction must be to focus on engaging retail investors in the disclosure process, rather than dismissing as pointless the idea of making disclosure accessible to retail investors. Investor education and greater awareness of cognitive biases in discharging the suitability obligation by advisors, may also improve financial understanding.

v. Disclosure and the Retail Investor

A more positive response to the question about the future of disclosure is to say that issuers should present disclosure so that retail investors can understand it. Since the research that has been done on retail investor financial literacy suggests that this is generally not at a very high level,³⁷ to conform all disclosure to the lowest common denominator would be to reduce the quality of disclosure dramatically and likely the efficiency of markets too. This squarely raises the question to which audience disclosure should be addressed. And if disclosure to various audiences is to be different, that raises the question of equality of access to securities information. Much effort has been expended in the last half decade to reduce instances of selective disclosure – mostly to curb the preferential treatment of institutional and other large shareholders.³⁸ Arguments against selective disclosure have rested mainly on values of fairness, but it may be that requiring issuers to make the same disclosure to all investors is counter to the purpose of investor protection, because retail investors are turned off by the volume and technicality of disclosed material, and do not read or understand it.

An important distinction should be made here. If we accept that because of continuous disclosure much information about issuers is already in the market before a prospectus is issued, it is likely that professional investors who follow an issuer will not find a great deal new in a prospectus. If we accept that the majority of retail investors are unlikely to understand the bulk of such a document, then the purposes of disclosure may not be furthered by current practice. The distinction which should be made is

³⁷ The Brondesbury Group for the Investor Education Fund, has done extensive research to find out what consumers wanted to know, how they spoke (actually words used) about those issues, and what their questions were. This combined with literacy research that showed that 43% of Canadians are at literacy level 1 or 2 out of 5 levels - 5 being the highest - with Level 3 being the level needed to be able to cope with today's knowledge society. Much of the investor education available right now is at Level 4 or 5 literacy levels.

³⁸ Above note 3 at 467-468.

between mandating a certain type of disclosure and delivery obligations, and providing equality and timeliness of access to information.

A credible and persuasive argument can be made for graduated disclosure: disclosure where information is formatted according to “user needs” and investors can choose the level of volume and technicality they desire. This approach is easily facilitated by the use of computers and the Internet, but of course most formats in which it is presented may be replicated on paper. The purposes of disclosure will likely be much better served if retail investors would consider some short and salient facts about an investment – price, risk levels, fees and charges, basic terms of the investment - and make their investment decision on that basis. If it were compulsory to give all investors a term sheet or key features document of this sort, a short description of the type and location of more detailed information could be provided for those investors who wanted to make a more considered decision. This location could be a URL (such as a SEDAR Internet address) where continuing disclosure about the company is posted and so is more detailed information about the particular investment being sold. In terms of information transmission, together these documents would be the functional equivalent of the current prospectus. They would however be presented in a fashion that might better engage investors at the level of their information needs and competence, and could be transmitted in a fashion that best ensures access to the information. The possibilities of this suggestion are explored further in Part 7 below.

vi. Recommendations

Recommendation #1: Disclosure should be made on graduated basis, formatted according to ‘user needs’ so that investors can choose the level of volume and technicality they desire.

Recommendation #2: It should be compulsory to give all investors some short and salient facts about an investment – price, risk levels, fees and charges, basic terms of the investment.

5. Technical Information About Electronic Document Transmission

It is helpful to conceive current and emerging practice in Internet securities disclosure at two levels. The first is really just using the Internet as a convenient and timely way to publish information in substantially the same form as it has been presented in the past, a text document, perhaps containing diagrams and charts. The PDF³⁹ and HTML⁴⁰ documents now common in securities disclosure are examples of this. The second level involves making the information available in a format that takes advantage of the analysis capacities of computer programs. Instead of simply publishing financial information electronically, this further level of digital disclosure changes the means of preparing, presenting and using the information. It connects these steps into one process, and also allows disclosed information to be manipulated and interpreted for different users and their purposes. Information can also be published by those different users in a fashion that highlights the purposes for which analysis was undertaken. An example of the second level of disclosure is the financial reporting language XBRL which has emerged from the meta-language XML. XBRL is discussed in more detail below, especially in Part 7. In the meantime we consider the common formats and technical limitations of current Internet based securities disclosure practice.

i. Formats in Which Documents May be Transmitted

The form in which documents and materials can be transmitted electronically is important for law. This is because the electronic format determines matters such as extent of access to documents; security or integrity of document form; readability and navigability; and ability to download or print out. Regulatory requirements as to security or stability of document form for example, may preclude some formats.

Regulators that mandate filing of documents may demand that a particular format be used for the version of the document that is filed. In the United States and Canada, differing approaches have been adopted by securities regulators with respect to the format of prescribed documents officially required to be filed.⁴¹ The United States Securities and Exchange Commission (SEC) accepts documents in HTML format via

³⁹ PDF stands for Portable Document Format and is a type of electronic document that retains the precise appearance of the source document.

⁴⁰ HTML stands for Hyper Text Mark-Up Language and is a format for electronic documents widely used on the Internet. It permits data to be linked across a variety of documents and sites.

⁴¹ For general discussion see E Boros "The Online Corporation: Electronic corporate communications" Discussion Paper Centre for Corporate Law and Securities Regulation at 29, December 1999 The University of Melbourne. Available <http://cclsr.law.unimelb.edu.au/research-papers/online-corporation.html>

EDGAR with PDF versions having an “unofficial status”.⁴² In a recent release the SEC has also encouraged the voluntary filing of financial information by corporations in XBRL.⁴³ Canadian regulators, though, prefer documents to be lodged in PDF format via SEDAR, a central registry for filing prospectuses. Initially, SEDAR accepted prospectuses formatted in PDF, Corel WordPerfect and Microsoft Word. However, due to problems of access with updated forms of Corel Microsoft SEDAR has decided in favour of PDF format.⁴⁴

The variety of documents and materials that is available through the Internet ranges from simple Word files solely incorporating text to more complex multimedia files incorporating elements such as sound, graphics and video. Additionally, Internet material may be presented in a selection of layouts including Word documents, Excel spreadsheets and PowerPoint presentations. Further choices are provided by the form of publication, which could cover preferences between HTML and PDF files. With such an array of formats and designs, legislators face challenges in balancing the incorporation of advances in technology into securities regulation while safeguarding investors and confidence in the market.⁴⁵

Two matters that immediately assume significance are the need to achieve security in documentation and the need to regulate the quality of information remitted to investors. With the former, a major concern will be to ensure that documents are not able to be altered and that access to these documents is limited to intended parties. In this regard PDF files are to be preferred to HTML. PDF files have the system capacity to incorporate features such as read-only documents, digital signatures and password security.⁴⁶ Moreover, if the document needs to be presented in a precise layout then PDF is the form of choice.

The second concern, the quality of information, exhibits a different level of significance in the electronic world from the paper-based world. In an electronic system, sound, video, promotional material and hyperlinks may be incorporated in a way that is just not possible in a paper-based system. Therefore,

⁴²Final Rule: Rulemaking for EDGAR System Release Nos. 33-7855; 34-42712; 35-27172; 39-2384; IC-24400 File No. S7-05-00. Available <http://www.sec.gov/rules/final/33-7855.htm>

⁴³ See below notes 148 and 149.

⁴⁴SEDAR National Instrument 13-101 *System for Electronic Document Analysis and Retrieval* (available <http://www.bcsc.bc.ca/policy.asp?id=2442>) Section 2.4 of the National Instrument specifies that electronic lodgement is to be made in accordance with the SEDAR Filer Manual. See section 7.2(b) of the SEDAR Filer Manual mandates the use of PDF. SEDAR Filer Manual is available http://www.sedar.com/sedar/sedar_filer_manual_en.htm

⁴⁵ CSA National Policy 11-201 “*Delivery of Documents by Electronic Means*” www.gov.ns.ca/nssc/docs/np11-201.pdf para 1.2.

⁴⁶ Adobe PDF “How to Create Accessible Adobe PDF Files” page 1 Available: <http://www.adobe.com/products/acrobat/pdfs/accessbooklet.pdf>

regulators face decisions on how tightly to regulate this aspect of document transmission.⁴⁷ For instance, if sound and video cannot be reproduced in paper format this means that those who access a paper version of a document would not receive the same information as those with an electronic version.⁴⁸ Another aspect of the quality question involves the use of hyperlinks. Hyperlinks can be useful for moving around a large document such as a prospectus. But they can be tricky where the hyperlink connects to an external site. First, the information contained in the external site may be incorrect and if it has been incorporated into the transmitted document issues of liability arise. Moreover, where a hyperlink is incorporated into a document being delivered electronically, questions occur regarding which documents are being delivered.

ii. Ensuring Access to Transmitted Documents

Access is defined in the Oxford Dictionary as “the right or opportunity to use something” or “the retrieval of information stored in a computer’s memory”.⁴⁹ It may entail not only the ability to obtain the information at present but can also extend to the ability to obtain the information at a later date. In document delivery terms, access has several dimensions. The first is of course access to a computer or the Internet and the knowledge to use it: we might call this physical access. Statistics Canada indicates that 64% of households in Canada have at least one member who uses the Internet, with 65% of regular users having a high-speed link to the.⁵⁰ Although this level of usage is significant as Geist points out it still means that not everyone has access to electronic means of communication.⁵¹

Also, statistics on physical access may obscure the fact that quality of access is equally important.⁵² So, a second dimension is quality of access. This can be lacking where a user has no high-speed connections and has problems logging on to sites and downloading information. Given that the most secure and commonly adopted method of publishing material on the Internet is using PDF format, this is frequently experienced if files are large.⁵³ Quality of access will be further diminished where a file contains graphics and video clips, and the user lacks the software to realise these features. This is a concern with multi-

⁴⁷ See generally D Kingsford Smith, “The Same Yet Different: Australian and U.S. Online Investing Regulation” *University of Toledo Law Review*, 37(1) in press.

⁴⁸ Above note 45 at para 3.4(1).

⁴⁹ Oxford Dictionary http://www.askoxford.com/concise_oed/access?view=uk

⁵⁰ Statistics Canada *Household Internet Use Survey* July 8, 2004
<http://www.statcan.ca/Daily/English/040708/d040708a.htm>

⁵¹ M Geist *Internet Law in Canada* Third Edition Captus Press 2002 at 803.

⁵² H Skinner, S Biscope, B Poland “Quality of access: barrier behind use statistics” *Social Science and Medicine* 57 (2003) 875-880 at 875.

⁵³ For a discussion of some of these problems see J Groves *Websites for Rural Australia Designing for Accessibility*, A report for the Research and Development Corporation February 2000 RIRDC Publication No 00/13 at 13-24. Available www.rirdc.gov.au/reports/HCC/00-13.pdf

media prospectuses, and is discussed in more detail later. Even if a user has everything required for good quality access, sometimes ISPs (Internet service providers) may set limits on file sizes that may be downloaded, providing another potential obstacle to good-quality access. One way to address these difficulties is for websites to provide hints or advice on how to handle difficulties with quality of access. The website of the Australian Securities and Investments Commission (ASIC), for instance, contains helpful information in this regard.⁵⁴ Website operators might also provide users with an alternate means of contact such as telephone.

Other problems of access may arise from the capabilities of the site being accessed. We might call this the site-capacity dimension of access. A site may not, for example, support a large number of users. Several reports undertaken in the securities field have analysed access issues, including a report undertaken in 1999 by the state of New York⁵⁵ and a report commissioned by the SEC “On-Line Brokerage: Keeping Apace of Cyberspace”.⁵⁶ Both reports highlighted problems associated with accessing broker sites. The majority of these problems related to the capacity of brokers’ systems to cope with the volume of traffic. By and large the problems represented system failures by the brokers’ computer networks.

In a client/server relationship computer services are ordinarily divided between a front-end system and a back-end system.⁵⁷ The front-end system contains information generally available such as financial news and general information. Normally any member of the public can log on and obtain this information.⁵⁸ The back-end part of the system contains database and network management operations crucial to brokerage activities.⁵⁹ The back-end part of the system for instance regulates the maintenance and publication of clients’ securities accounts. Problems of access can occur if clients are unable to log on to these systems or if response time is slow.⁶⁰

Customers gain access to the back-end systems by a portal in the front-end system. Any blockages in the front-end system will have a flow-on effect to access in the back-end system. Blockages may occur

⁵⁴ ASIC “Using our website”

<http://www.asic.gov.au/asic/asic.nsf/byheadline/Hints+for+using+our+website+asic+version?openDocument>

⁵⁵ E Spitzer, Office of New York State Attorney General, From Wall Street to Web Street: A Report on the Problems and Promise of the Online Brokerage Industry November 22, 1999. Available www.oag.state.ny.us/investors/1999-online-brokers/brokers.html at 89.

⁵⁶ Available at www.sec.gov/pdf/cybrtrnd.pdf

⁵⁷ In a system there are also middle layers that hold information such as operational sequences common to both systems. See http://www.linktionary.com/b/back_end.html

⁵⁸ Above note 55 at 90-91.

⁵⁹ Linktionary “Back-end Systems.” http://www.linktionary.com/b/back_end.html

⁶⁰ Ibid.

because of increases in the volume of traffic to the front-end system or because the network system is not geared towards the handling the volume of traffic, so the client's quality of access is degraded.⁶¹ Clients could encounter delays in logging onto the system and this could be an important drawback where regulation or customer contracts make it obligatory for customers to browse information. Further problems may arise from system management practices where a session times out before a customer has had a chance to obtain the information. A client could be timed out because the system was hampered by slow responses, which may be further exacerbated if the customer is not connected to high-speed service.⁶² A further problem may occur from session management where only one client per protocol address (IP)⁶³ is allowed access. Where clients use a "proxy server"⁶⁴ and more than one client uses the same proxy server, the address of the broker will only recognize the address of the proxy server - not the individual clients. This might mean that only the first client to log on using that proxy server will gain access, with subsequent customers being denied entry into the system.⁶⁵

Under section 15(b)(7) of the Securities Exchange Act the Commission has the capacity to specify standards rules and regulations with respect to the operations of brokers.⁶⁶ The Commission has issued direction by way of Staff Legal Bulletin no. 8 that was designed to provide guidance to brokers in case of outages and also act as a reminder of their obligations to provide a computer system with sufficient capacity to cope with expected volumes of work.⁶⁷ A proposed rule 15b7-2⁶⁸ would have imposed specific obligations with respect to systems capacity but it appears not to have come into existence.

iii. Problems of Proof of Delivery or Access

The link between the difficulty of proving delivery of documents and access (including quality of access)

⁶¹ Above note 55 at 93-94, 97-98.

⁶² Above note 55 at 94.

⁶³ An IP address is a unique number that is used on a network to identify any participating device including computers, routers and fax machines. The address indicates where information should be sent.
http://en.wikipedia.org/wiki/IP_address

⁶⁴ A proxy server permits indirect connections to the via the computer network of the intermediate (proxy) server.
http://en.wikipedia.org/wiki/Proxy_server

⁶⁵ Above note 55 at 95-96.

⁶⁶ Securities Exchange Act 1934 15 U.S.C. § 78(o) Section 15(b)(7) Available at
<http://www.law.uc.edu/CCL/34Act/sec15.html>

⁶⁷ Staff Legal Bulletin No 8 (MR) September 9, 1998. Bulletins do not operate as a regulation or rule. Available
<http://www.sec.gov/interp/legalslbr8.htm>

⁶⁸ See discussion in U.S. Securities and Exchange Commission *On-Line Brokerage: Keeping Apace of Cyberspace* November 1999 at 59. Available www.sec.gov/pdf/cybrtrnd.pdf. See also P J Bezanson "Online Brokers and the SEC: Still Working out the Glitches" 2002 *Duke L.&Tech Rev.*0022 11/6/2002. Available
<http://www.law.edile/edu/journals/dltr/articles/2002dltr0022.html>

to facilities was made clear in the decision of the United States' Supreme Court in *Rio Properties Inc v Rio International Interlink*.⁶⁹ Although the Supreme Court in that case permitted service of court process by e-mail it was only permitted on the limited basis that the defendant had structured its business in such a manner that e-mail service was the only option. The court pointed out that general problems, may arise from using the Internet for delivery of documents:

“In most instances there is no way to confirm receipt of an e-mail message.....
system compatibility problems may lead to controversies over whether an exhibit or
attachment was actually received. Imprecise imaging technology may even make
appending exhibits and attachments impossible in some circumstances...”⁷⁰

Geist, however points out that where laws require a record to be maintained such as delivery of prospectus information, the use of electronic media does not operate as a waiver on this requirement because technology is able to maintain records of who has accessed the relevant website. Computer software is certainly advertised as capable of providing such services.⁷¹ Alternatively prior consent may be obtained to remit documents in electronic format.⁷²

The issues of document format, access and evidence of delivery just canvassed, are important because of the criteria for acceptable electronic delivery that have been set by Canadian securities regulators.⁷³ Canadian National Policy 11-201 specifies four basic components to electronic delivery: notice must be given to the recipient that the document has or will be sent, the recipient has simple access to the document, the delivering party has evidence that the document was delivered, the document received by the recipient is not different from the document delivered or made available by the deliverer. These requirements are similar to those in the U.S.. There requirements are that the information must have been

⁶⁹ *Rio Properties Inc v Rio International Interlink* 284 F.3d 1007 (2002). Available at <http://caselaw.lp.findlaw.com/data2/circs/9th/0115466p.pdf>

⁷⁰ Ibid at 1018.

⁷¹ A press release issued with respect to the on-line banking facilities of the First National Bank highlighted the merits of ACI software that was able to track precisely “*the status of each message including up to date details of when it was submitted relayed, delivered, viewed and acted upon.*” Press release FNB to Launch Electronic Document Delivery with Software from ACI Worldwide.
http://www.aciworldwide.com/news/newsdetail.asp?news_id=320 ACI site <http://www.aciworldwide.com/>

⁷² Above note 51 at 789.

⁷³ Similar approaches have been taken in comparable securities markets: Securities and Exchange Commission “*Use of Electronic Media for Delivery Purposes*” 17 CFR PARTS 231, 241 and 271 Release No. 33-7233; 34-36345; IC-21399 FILE NO. S7-31-95 RIN 3235-AG67. Available at <http://www.sec.gov/rules/concept/33-7233.txt> pages 7 and 8.

effectively communicated,⁷⁴ that it must be practically accessible and available,⁷⁵ that it should be accessible in the future⁷⁶ and that consideration should be given to a system that is able to evidence delivery.⁷⁷ These matters will be considered further as this report progresses.

iv. Transmission Security and Electronic Signature Options

A final issue to be considered is that of confidentiality or security of documents transmitted. Of course not all documents will need to be transmitted in a confidential way, indeed in some cases such as prospectuses, just the opposite is desired. However, it will usually be important to all securities documents including prospectuses, that their form and content is secure and that they will be accessed or delivered to the recipient in the same condition in which they were sent. As already discussed, certain electronic formats, such as PDF, promote that result.

At another level, such as the broker/client relationship, what is really in issue is the ability of the client to access personal account information and to use the broker's system for trading with a secure and private right of entry. The commercial practice here is the obtaining of access to sites via passwords⁷⁸ and PINs.⁷⁹ This is a means of authenticating the customer, but is also a mark of intention to enter a transaction, in a fashion similar to a traditional signature. This somewhat blurs any hard and fast distinction between the use of PINs and passwords, and the more sophisticated electronic signatures discussed below. In this way passwords and PINs can act as a type of electronic signature.⁸⁰

Authentication techniques vary and can include mechanisms anchored in a form of secret knowledge such as a password or PIN; procedures based on the possession of an item such as a card; or, authentication by recognition of a unique physical attribute such as a fingerprint.⁸¹ Frequently, authentication may involve a combination of mechanisms such as the combined use of passwords and access cards as occurs with the

⁷⁴ Ibid at 7 and 8.

⁷⁵ Ibid at 7.

⁷⁶ Ibid at 8.

⁷⁷ Ibid at 11.

⁷⁸ A secret form of authentication. Available <http://en.wikipedia.org/wiki/Password>

⁷⁹ A Personal Identification Number that is a type of password, regularly used in automatic teller machines. http://en.wikipedia.org/wiki/Personal_identification_number

⁸⁰ See discussion below in text surrounding footnotes 89 – 93.

⁸¹ Australian Government Department of Communications, Information Technology and the Arts. How do e-security technologies work? July 20002. Page 2 Available: http://www.dcita.gov.au/ie/publications/2002/july/trusting_the_internet_-_a_small_business_guide_to_e-security/how_do_e-security_technologies_work

use of automatic teller machines.⁸² Password only systems are regarded as the least secure but they are still relevant as a means of screening access to sites. Security is often achieved by securing the use of the site itself with a Secure Sockets Layer (SSL)⁸³ that is used in conjunction with user names and passwords or PINs to enable private communications.⁸⁴ SSL technology is automatically provided with most Web browsers and readily permits the end user to decrypt messages.⁸⁵

At yet another level, some securities documents such as proxy notices may require a signature. A signature on a manuscript document comprises a mark placed on the surface of the document indicating agreement to be bound⁸⁶ and additionally may be used to verify identity. The importance of the signature lies in the intention behind the affixing of the mark rather than the nature of the mark itself. Therefore, whether the signature is affected by way of a mark made on the surface of a manuscript document or by other means suitable to an electronic document, the signature should be capable of binding the signatory to the document. This means that an electronically-generated signature should fulfil at least three requirements: it should be authentic, it should be capable of maintaining the integrity of the document and the signatory should not be able to repudiate the signature.⁸⁷ Much depends on how electronic signatures are executed.

Where signature is an essential component of a transaction and a high degree of security is required, the most secure connection is one that uses PKI or public key infrastructure. At present PKI is used on high levels by government agencies. A less expensive alternative is Pretty Good Privacy (PGP)⁸⁸ which permits secure communication but does not provide the same high degree of authentication that PKI does.⁸⁹ Presently where a signature is required by securities laws, most often the security holder or customer is asked to print out and fax or post a manually signed page. This is because of the difficulties surrounding electronic signatures.

⁸² Ibid.

⁸³ SSL uses cryptographic protocols that permit secure exchange of information on the web but only the server is independently authenticated. http://en.wikipedia.org/wiki/Secure_Sockets_Layer

⁸⁴ Above note 81 at 3.

⁸⁵ J T Dillon for the New York State Office for Technology “NYS Best Practice Guideline #G04-001 Electronic Signatures and Records (ESRA) Guidelines. 2004 Part 2.6 Available

http://www.oft.state.ny.us/esra/Guidelines_files/index.htm 2.6 E-signature Approaches available

http://www.oft.state.ny.us/esra/Guidelines_files/02-06.htm

⁸⁶ See for instance *L'Estrange v Graucob* [1934] 2 KB 394, *Toll (FGCT) Pty Limited v Alphapharm Pty Limited*. [2004] HCA 52 Available at <http://www.austlii.edu.au/au/cases/cth/HCA/2004/52.html>

⁸⁷ M J Radin, J Rothschild, G M Silverman *Internet Commerce* New York, New York Foundation Press 2002 at 373.

⁸⁸ The system became available in 1991 and is regularly used for secure e-mail communication. It allows users to set their own public and private user keys and because it lacks identity verification by an independent third party it is not regarded as secure as PKI. <http://en.wikipedia.org/wiki/PGP>

⁸⁹ Above note 81 at 4.

The varying levels of security (signatures, PINs and passwords) are evident in systems for filing securities documents with the regulator. In Australia, Elizabeth Boros has identified differing levels of security and access for differing purposes with respect to lodgement of documents with ASIC.⁹⁰ The first level which is available to those with high volume needs such as accountants involves the use of passwords supplemented by a user agreement. The next level is available to clients of ASIC who are able to access their company details and entry is achieved via the use of a PIN. The third level is the most secure and is used for instance for electronic registration of companies. This process uses digital signature keys stored on smartcards and accompanying encryption technology.⁹¹ SEDAR uses a protocol of subscriber IDs and personal identification numbers with user IDs along with passwords for individuals within the user organisation.⁹²

In summary, there is a wide range of authentication or electronic and digital signature techniques. Those adopted will depend on the level of security desired or required by law. It will also depend on commercial or practical considerations such as liability for breach of security and whether individuals or organisations have access to encryption software etc. These kinds of considerations are particularly in point when wholly electronic issues are contemplated,⁹³ and when wholly electronic disclosure formats such as XBRL are in use.

⁹⁰ Australian Securities and Investments Commission. Website <http://www.asic.gov.au/asic/asic.nsf>

⁹¹ Above note 41.

⁹² SEDAR Filer Manual, above note 44, part 7.0 section 4.7.

⁹³ Above note 47 - see generally part III(d) that deals with suitability and electronic applications in the Electronic Selling of Other Financial Products - Compulsory Superannuation Choice and Online Calculators.

6. Areas in Which Canadian Securities Law Currently Requires Paper or Electronic Filing or Delivery

i. Delivery (Through Filing) of Information by Issuer to Regulators

Canadian securities laws currently permit certain of the documents that must be filed with securities regulators to be filed using electronic means. Generally, unless a document is permitted to be filed electronically pursuant to an applicable instrument or policy, it must be filed in paper form.⁹⁴

Overview of the System for Electronic Document Analysis and Retrieval (SEDAR)⁹⁵

On January 1, 1997, the securities regulatory authorities in Canada implemented the necessary legal framework establishing SEDAR for the mandatory filing by electronic means of the majority of the documents that must be filed with securities regulators. In its report to the Task Force, Stikeman Elliott has provided a complete list of the securities filings that must be transmitted using SEDAR.

National Instrument 13-101 – *SEDAR* (“NI 13-101”) sets out the requirements governing electronic filings with the securities regulators. It also prescribes: (a) the categories of filers that are required to make electronic filings,⁹⁶ (b) the specific types of filings that are required or permitted to be transmitted in electronic format (which includes all of the documents that form a reporting issuer’s continuous disclosure record, as discussed below), (c) the requirements for persons seeking to access the SEDAR system to make filings, and (d) the manner in which electronic filings are to be prepared and transmitted. SEDAR is operated by CDS Inc., a subsidiary of the Canadian Depository for Securities Limited, the central clearinghouse for securities in Canada.

SEDAR serves several functions. Electronic filings using SEDAR significantly reduce the time and effort required by issuers to file documents with securities regulators. Before SEDAR, filings were required to

⁹⁴ An obvious example is the report that must be filed with securities regulators when securities are distributed pursuant to a prospectus exemption under National Instrument 45-106 – *Prospectus and Registration Exemptions*. Available <http://www.bsc.bc.ca/policy.asp?id=2736>

⁹⁵ In this and the next 3 paragraphs I use material provided by Stikeman Elliott.

⁹⁶ Generally, the following entities are required to file documents electronically: 1. Every issuer, other than a foreign issuer (SEDAR) (as defined in NI 13-101), that is required or otherwise is proposing to file a document under securities legislation or securities directions, 2. Every foreign issuer (SEDAR) (as defined in NI 13-101), that files a notice of election to become an electronic filer and 3. Every third party filer that makes a filing of a type to which this Instrument applies concerning an issuer that is required to comply with this Instrument. National Instrument 13-101 – *System for Electronic Document Analysis and Retrieval* (SEDAR).

be made with each provincial securities regulator separately. SEDAR, as the central repository for filings with each of the Canadian securities regulators, allows issuers to make one filing of each document. Similarly, SEDAR facilitates the electronic payment of required filing fees and allows for “one stop” payment. Most importantly, filings made using SEDAR are posted under the reporting issuer’s profile on the SEDAR website⁹⁷ thereby creating a publicly accessible full record of all of the public disclosure required to be made by a reporting issuer under Canadian securities laws. SEDAR is central to continuous disclosure, the fact of which underpins recommendation #3 in Part 6 below.

The Annual Information Form

Perhaps the leading example of this is the Annual Information Form (AIF), since it is the foundation for the short-form prospectus.⁹⁸ The AIF is intended to provide the public with relevant background material essential to a proper understanding of the reporting issuer, its operations and prospects for the future. The prescribed contents of an AIF include information regarding the incorporation or organization of the issuer, its subsidiaries, the general development of its business, a narrative description of its business, selected consolidated financial information, MD&A, the market for its securities, directors and officers, and certain additional information. The AIF must describe any contract that the reporting issuer’s business is substantially dependent on (other than those entered into in the ordinary course of business).⁹⁹ Social and environmental policies of the reporting issuers must also be described in the issuer’s description of their business if such policies are “fundamental to the issuer’s operations.” In short, an AIF very much resembles a long form prospectus and, indeed, forms the foundation for a short-form prospectus as discussed below. The AIF must be filed promptly after the end of the reporting issuer’s most recently completed financial year. As already mentioned, there is no requirement to deliver an AIF to security holders.

Following an Initial Public Offering of securities using a long-form prospectus, the issuer becomes a reporting issuer under Canadian securities laws and is subject to the continuous disclosure requirements provided for in National Instrument 51-102, *Continuous Disclosure Obligations* (NI 51-102).¹⁰⁰ The documents that are required to be filed or delivered pursuant to NI 51-102 build upon the disclosure provided in the long-form prospectus and create the disclosure record of the reporting issuer. As time progresses, securities regulators and the investing public have a fuller track record on which to assess the

⁹⁷ Unless such a filing is made on a confidential basis as is permitted in certain limited circumstances.

⁹⁸ In this and the next three paragraphs I rely on material provided by Stikeman Elliott.

⁹⁹ The CSA appears to view the “ordinary course of business” concept quite broadly.

¹⁰⁰ The requirements of NI 51-102 continue until the issuer ceases to be Reporting Issuer.

activities of a reporting issuer and measure the value of its securities. Moreover, the disclosure record is intended to serve as the foundation for subsequent issuances of securities by a reporting issuer.

Most reporting issuers can access the Canadian capital markets and issue securities by filing a short-form prospectus as provided by National Instrument 44-101 – *Short-form Prospectus Distributions* (NI 44-101). Eligibility for filing a short-form prospectus applies to all issuers listed on the TSX, Tier 1 and Tier 2 of the TSX-V and the Canadian Trading and Quotation System. In addition, to be eligible to file a short-form prospectus, an issuer must satisfy the following conditions:¹⁰¹

- (a) the issuer must be an electronic filer under NI 13-101;
- (b) the issuer must be a reporting issuer in at least one jurisdiction of Canada;
- (c) the issuer must have filed, with the securities regulatory authority in each jurisdiction in which it is a reporting issuer, all periodic and timely disclosure documents that it is required to have filed in that jurisdiction;
- (d) the issuer must have, in at least one jurisdiction in which it is a reporting issuer, current annual financial statements¹⁰² and a current annual information form,¹⁰³ and
- (e) the issuer's equity securities must be listed and posted for trading on a short form eligible exchange and the issuer may not be an issuer whose operations have ceased, or whose principal asset is cash, cash equivalents, or its exchange listing.

The short-form prospectus is intended to be a slim document that incorporates by reference the reporting issuer's disclosure record and provides any update regarding its business, affairs and financial position

¹⁰¹ National Instrument 44-101 – *Short-form Prospectus Distributions* (NI 44-101) at paragraphs 2.2 and 2.3. In certain narrow circumstances, NI 44-101 also provides that the requirements to have a current AIF and current annual financial statements do not apply. See paragraph 2.7. National Instrument 44-101 available from http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/rm_part4_index.jsp

¹⁰² Current annual financial statements are similarly defined as: 1. “the issuer’s comparative annual financial statements filed in accordance with the applicable continuous disclosure rule for its most recently completed financial year, together with the auditor's report accompanying the financial statements and, if there has been a change of auditors since the comparative period, an auditor's report on the financial statements for the comparative period, or 2. the issuer's comparative annual financial statements filed for the financial year immediately preceding its most recently completed financial year, together with the auditor's report accompanying the financial statements and, if there has been a change of auditors since the comparative period, an auditor's report on the financial statements for the comparative period if: a) the issuer has not filed its comparative annual financial statements for its most recently completed financial year, and b) the issuer is not yet required under the applicable continuous disclosure rule to have filed its annual financial statements for its most recently completed financial year.”

¹⁰³ A "current" AIF is the issuer's AIF filed in respect of its most recently completed financial year, or its immediately preceding financial year if an AIF for the most recently completed financial year has not been filed and the issuer is not required to have filed its annual financial statements for its most recently completed financial year.

since the last continuous disclosure filing. The rationale is that certain disclosure, which is already publicly accessible on SEDAR to prospective purchasers, but generally not delivered to security holders, need not be repeated in the short-form prospectus.

ii. Delivery of Documents to Present and Future Security Holders

In Canada certain documents required to be delivered to security holders may also be delivered by electronic means. What follows is first, an overview of the various instruments and policies that permit electronic filing and delivery. As with filing, unless a document is permitted to be delivered electronically pursuant to an applicable instrument or policy, it must be filed or delivered in paper form.¹⁰⁴ Then, there is consideration of how electronic delivery operates in relation to two very important documents which require delivery: prospectuses and proxy forms with accompanying information circulars. The former is of course delivered to prospective security holders and the latter to current security holders.

The development of SEDAR is illustrative of the adoption of technology to facilitate the electronic filing of documents with securities regulators and the creation of publicly accessible locations for such documents.¹⁰⁵ The development of National Policy 11-201 - *Delivery of Documents by Electronic Means* (“NP 11-201”) was a step in the same direction with respect to document delivery to security holders.¹⁰⁶ It should be noted at the outset however that NP 11-201 is only a policy statement of the securities regulators and therefore, unlike NI 13-101 or NI 55-102, cannot be used to require the electronic delivery of documents to security holders.¹⁰⁷ NP 11-201 merely provides policy guidance on the methods of electronic delivery that are viewed as permissible by the securities regulators.

NP 11-201 provides guidance on the use of electronic means to deliver documents such as prospectuses, financial statements, trade confirmations, account statements and proxy solicitation materials, all of which are required to be delivered to a reporting issuer’s security holders.¹⁰⁸ Unless such documents are

¹⁰⁴ An obvious example is the report that must be filed with securities regulators when securities are distributed pursuant to a prospectus exemption under National Instrument 45-106 – *Prospectus and Registration Exemptions*.

¹⁰⁵ In this and the next 5 paragraphs, I rely on material provided by Stikeman Elliott.

¹⁰⁶ The United States Securities and Exchange Commission has adopted instruments of a similar nature. See, generally above note 73.

¹⁰⁷ See, David Johnston and Kathleen Doyle Rockwell, *Canadian Securities Regulation*, 3rd ed. (Markham: LexisNexis Canada Inc., 2003) at 51 and Jeffrey MacIntosh and Christopher Nicholls, *Securities Law*, (Toronto: Irwin Law, 2002) at Chapter 3.

¹⁰⁸ Above note 45. Subsection 1.3(5) of National Policy provides that: “This Policy does not apply to documents filed with or delivered by or to a securities regulatory authority or regulator.”

delivered to security holders electronically in compliance with NP 11-201, they are expected to be delivered in paper form.

NP 11-201 sets out the way in which obligations imposed by provincial Instrument 45-106 – *Prospectus and Registration Exemptions* to securities legislation to “deliver” documents can be satisfied by electronic means, but does not override where the method of delivery is specifically mandated by securities legislation. In particular, NP 11-201 requires the deliverer of a document to provide evidence that the document has been delivered or otherwise made available to the recipient, and to ensure that the recipient receives notice of the electronic delivery, has easy access to the document and, in fact, receives a document that is not different from that delivered by the deliverer. Under NP 11-201, a deliverer will generally satisfy the notice, evidence and access components of electronic delivery by obtaining the informed consent of an intended recipient to the electronic delivery of a document and then delivering the document in accordance with the consent.

Prospectuses

In Canada, as in the U.S., it is likely that two versions of the prospectus are delivered to the person who is the eventual security holder – the preliminary prospectus and the final prospectus.¹⁰⁹ NP 201-11 makes it possible for both to be delivered electronically. In the U.S. in 2005 securities law reforms have moved to allowing an access equals delivery approach, but only for the final prospectus.¹¹⁰ This leaves both Canadian and U.S. issuers with the need to obtain consents to delivery of one or both of these documents. However, in the U.S. ‘well known’ and ‘seasoned issuers’ may now use ‘free-writing prospectuses’ to sell the issue which may be transmitted electronically without proof of delivery.¹¹¹ This alleviates many of the problems concerned with obtaining consents. It may be that many preliminary prospectuses are sent to investors already on the issuing broker’s database, who have given ‘omnibus’ consents – i.e. they have agreed to receive any documents from any company electronically. But this still leaves the practical problem of how to solicit consents where there is no preexisting relationship between a prospective investor and the company or its broker, and the aim is to attract new security holders to the company’s share register.

¹⁰⁹ OSA ss. 65(2) & 66 for the preliminary prospectus, and ss71(1) as to the final prospectus. Both documents can be delivered electronically under National Policy 11-201. See above note 45.

¹¹⁰ Friedman above note 9, 2-4.1 (2006 Suppl).

¹¹¹ See generally above note 10.

Proxy Forms and Information Circulars

NI 51-102 requires the filing of information circulars and proxy-related material with securities regulators.¹¹² NI 54-101 works in conjunction with NI 51-102 to facilitate delivery of the pertinent proxy documents to security holders. In particular, the purpose of NI 54-101 is to ensure that beneficial owners of securities receive proxy-related and other security holder materials and are given the opportunity to vote the securities they own.

NI 54-101 permits direct communication between reporting issuers and beneficial owners of securities and between third parties, such as bidders and opponents in a proxy battle, and beneficial owners of securities. Under NI 54-101, intermediaries provide lists (“NOBO lists”) to Reporting Issuers containing the names, addresses, e-mail addresses and holdings of beneficial owners of securities who have not objected to the release of this information (NI 54-101 calls these beneficial owners “non-objecting beneficial owners” or “NOBOs”). It is of note that NI 54-101 permits communication by electronic means, such as by e-mail, if consent is first obtained.

Under NI 54-101, beneficial owners of securities can decline to receive materials relating to routine business (such as the election of directors and the appointment of auditors) and non-mandated materials (such as voluntary corporate communications) but are required to receive special meeting materials. Moreover, if a Reporting Issuer agrees to pay the cost of sending materials to the beneficial owner, it can require the intermediary to override the beneficial owner’s decision not to receive materials relating to routine business and non-mandated materials.

NI 54-101 does not mandate a delivery method for communication with beneficial owners of securities. However, NP 11-201 (discussed above) is applicable and permits reporting issuers to satisfy their document delivery obligations by electronic means. As such, reporting issuers can use the e-mail addresses obtained from the NOBO list to send proxy related and other documents to beneficial owners of securities, provided prior consent from the beneficial owner is obtained.

iii. Delivery of Information or Documents by Broker-Dealer to Customer

The final category of document delivery obligations to be considered is delivery by broker-dealer to

¹¹² In this and the next five paragraphs I rely on material supplied by Stikeman Elliott.

customer. Especially in the growing cohort of online investors who trade using the Internet rather than by telephone with a traditional advisory broker, most communication and document delivery is already electronic. Australian research indicates that even where trading is done traditionally, many investors still use the for information seeking, and may well have an e-mail account for receipt of notices.¹¹³ In most online investing customer contracts, the electronic and other modes by which the broker will deliver documents and information are specified. By transacting using the online account established under such a contract, the customer may well have indicated contractual agreement to these terms.

However, in relation to documents where there is a legislative obligation for delivery under the securities laws, it is probably necessary to obtain a consent to electronic delivery that is independent of - and likely additional to - the customer contract. This additional requirement is in order that the customer's consent is informed and freely given as required by National Policy 11-201 Delivery of Documents by Electronic Means.¹¹⁴ That National Policy encourages the use of electronic delivery of documents, but urges the use of a particular form of consent. Further the National Policy stipulates that the customer should not be required to consent to electronic delivery, a point which may be in doubt if the consent is part of the customer contract. Finally, consent must be informed, and not merely a term of a wider agreement requiring the customer to consent. This is especially if it is a "global consent", covering all documents to be delivered by or on behalf of an issuer or an "omnibus consent", covering documents from a number of issuers.¹¹⁵ In these circumstances the consent should be in an independent part of the account opening documentation, or in a different document altogether.

Trade Confirmations and Account Updating

Canadian legislation requires the delivery by the broker-dealer to the customer of a number of documents. Prime amongst these are trade confirmations and account updating information. Each dealer, subject to certain exceptions, is required to deliver updated account information to each client at the end of each month in which the client has effected a transaction or quarterly if the account has not been active.¹¹⁶

¹¹³ Kingsford Smith & Williamson, 'How Do Online Investors Seek Information, And What Does This Mean for Regulation?' 2004 (2) *The Journal of Information Law and Technology* at 12. Available at http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2004_2/kingsford-smithandwilliamson/

¹¹⁴ Above note 45.

¹¹⁵ Securities and Exchange Commission, *Use of Electronic Media*, Release Nos 33-7856, 34-42728, IC-24426, Effective 4 May 2000, para II.A.2.

¹¹⁶ OSR section 123, provide that: a dealer shall send a statement of account to each client at the end of each month in which the client has effected a transaction, where there is a debit or credit balance or securities held, (2) where a client has not effected a transaction but there are either funds or securities held by the dealer on a continuing basis, the dealer shall forward a statement of account to the client showing any debit or credit balance and the details of

iv. Policy Discussion of Current Canadian ‘Delivery’ Requirements

Having set out the circumstances in which e-delivery is permitted, what follows is a discussion of the means of that delivery and the difficulties it presents. The discussion begins with an overview of SEDAR.

SEDAR as the Basis for Transmission of Securities Information

Perhaps the most important aspect of SEDAR is the degree to which it is an up-to-date, publicly available resource of free information on Canadian reporting issuers – i.e. that category of corporation in which there is the largest public interest in continuing prosperity. This is also true of the U.S. counterpart, EDGAR. The extent to which this is so may be seen by contrasting the Australian position. Like SEDAR the Australian Securities and Investments Commission (ASIC) makes available comprehensive electronic filing facilities for issuers (and companies more generally), financial services providers and other categories of third parties.¹¹⁷ To search and retrieve information from the ASIC database, a member of the public has to use the services of one of ASIC’s accredited data-agents, and pay a fee.¹¹⁸ As a result many large public corporations in Australia make available for free those documents in which they think

any securities held or owned not less than once every three months, (3) The statements required by subsections (1) and (2) must list the securities held for the client and indicate clearly which securities are held for safekeeping or in segregation.

¹¹⁷ Section 11(1) of the Australian Securities and Investment Commission Act 2001 gives ASIC certain powers including those conferred by the Corporations Act 2001. Available http://www.austlii.edu.au/au/legis/cth/consol_act/asaica2001529/s11.html Part 5B of the Corporations Act 2001 gives ASIC the power of general administration of the Corporations Act. Available http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s5b.html With respect to disclosure documents, section 353 of the Corporations Act 2001 acknowledges that ASIC may determine conditions for electronic lodgment of documents. Available http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s353.html . ASIC permits company documents such as Audit Reports (form FS71) and Profit and Loss statements (FS70) to be lodged online. A company officeholder or authorized registered agent applies for a “corporate key” which is an eight digit number similar to a PIN. This gives the holder access to ASIC’s site. See http://www.asic.gov.au/asic/asic_srchlodg.nsf/byheadline/ASIC+Corporate+Key?openDocument Users must agree to adhere to the Electronic Lodgement Protocol (ELP). Available http://www.asic.gov.au/asic/ASIC_SRCHLODG.NSF/byheadline/Electronic+Lodgement+Protocol?openDocument With respect to prospectuses, Part 6D of the Corporations Act regulates fundraising but does not specifically regulate electronic prospectuses. ASIC has the power to grant relief from the provisions of Corporations Act 2001 and with regard to prospectuses has released a number of policy statements: Policy Statement 51 - Application for relief. Available http://www.asic.gov.au/asic/asic.nsf/lkuppdf/ASIC+PDFW?opendocument&key=ps51_pdf Policy Statement 56 – Prospectuses. Available from [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps56.pdf/\\$file/ps56.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps56.pdf/$file/ps56.pdf) ; Policy Statement 107 - Electronic Prospectuses. Available from [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps107.pdf/\\$file/ps107.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps107.pdf/$file/ps107.pdf)

¹¹⁸ The information may be accessed through ASCOT, the national corporate data base, on payment of a prescribed fee. The data agents are known as “information brokers”, they are authorised to carry out search functions and a list of them is available at http://www.asic.gov.au/asic/asic_srchlodg.nsf/byheadline/Information+brokers?openDocument

investors and prospective investors will be interested, on their Investor Relations websites. There is some functional equivalence between this arrangement and the links often found on the Investor Relations websites of Canadian companies, to recent filings of an issuer with SEDAR. The Australian arrangement has the advantage that prospectuses and annual reports¹¹⁹ may be made available in more attractive formats than the plain text documents prepared for filing with SEDAR. In that way they are more useful for the selling and publicity purposes these documents serve, along with information delivery. They appear in attractively designed formats, with graphics and diagrams, graphs etc¹²⁰. This along with other factors discussed below, makes reliance on the dissemination of paper versions less common in Australia.

However, as a public information resource, SEDAR is much more comprehensive, more authoritative and more attractive to investors because it is free. Australian public companies have few requirements as to what they must put on their Investor Relations websites,¹²¹ and even whether they must maintain one. With few exceptions it is up to management as to what appears on the site, how long it is there, its presentation, its completeness and so on. There are the general constraints of liability for misleading and deceptive behaviour,¹²² but these are ex post remedies with all the shortcomings such remedies possess. By contrast, SEDAR makes all the issuer's filings available publicly, they are complete and they are maintained on the site for a long period.

Aspects of SEDAR's operations, however, have been criticized. Problems seem attributable to the structure of SEDAR's website, to the size of files that investors need to access and to mechanical failures such as outages. These are all difficulties that are discussed more generally in Part 5 above. The problem

¹¹⁹ Delivery of these to shareholders is compulsory, and much content is mandated. See, for instance, sections 709-721 of the Corporations Act for prospectuses and other disclosure documents and sections 292-306 of the Corporations Act for annual reports. Sections available from http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/

¹²⁰ See for instance, annual report for PHP Billiton Ltd 2005 available at http://www.bhpbilliton.com/bbContentRepository/Reports/bhpb_ltd_concise_ar05.pdf; annual report for IAG Ltd available at http://www.iag.com.au/pub/iag/results/html/executive_team.htm; prospectus for D'Aguilar Gold Limited available at <http://www.daguilar.com.au/D'Aguilar%20Gold%20Ltd.pdf>; prospectus for Phone Zone Ltd, available at http://www.fonezone.com.au/pdf/prospectus_fonezone_sep_05.pdf

¹²¹ Above note 119, Prospectus provisions; Australian Stock Exchange, ASX Principles of Good Corporate Governance and Best Practice Recommendations. Available <http://www.shareholder.com/shared/dynamicdoc/ASX/364/ASXRecommendations.pdf>; ASX Listing Rules, Chapter 3 Continuous Disclosure. Available <http://www.shareholder.com/shared/dynamicdoc/ASX/364/ASXRecommendations.pdf>

¹²² Sections 12A and 12B Australian Securities and Investment Commission Act, Sections 278 and 729 Corporations Act.

of website structure is common to any situation where large volumes of material are involved.¹²³ Studies indicate that often a trade-off is involved between “coverage and functionality.”¹²⁴ It may, for instance, mean that information accessed on the Internet is not arranged in a user-friendly or rational manner,¹²⁵ that URLs do not work properly and that connecting sites have changed without being updated. Studies undertaken on the use of SEDAR for gathering information on mutual funds have pinpointed a number of problems. One study draws attention to the fact that generally SEDAR has been “structured with the filer in mind” rather than the investor, making it difficult to find information.¹²⁶ As an example one of the submissions made to the Joint Forum Consultation Paper highlighted the fact that in some parts of a search the system requires searchers to open documents marked “Other” but without knowing which of the “Other” documents contains the information that is needed making the search process unnecessarily lengthy.¹²⁷ A recent visit to SEDAR showed that documents central to a reporting issuer’s record such as director’s and auditor’s reports and meeting circulars were presented in this manner. Similar criticisms regarding ease of use of SEDAR have been reiterated elsewhere. IR Web Report¹²⁸ has identified the need to use a CAPTCHA¹²⁹ as a barrier that might deter some users who are not computer literate.

The second problem relates to the size of files which is coupled with the use of PDF as the preferred format. As discussed in Part 5, for reasons of security and uniformity PDF has been chosen by SEDAR for Internet publishing of prospectuses and proxy document. However several problems with PDF can discourage investors from accessing material.¹³⁰ These include the length of time taken to download files¹³¹ and difficulties associated with the legibility of documents.¹³² Although print size can be enlarged,

¹²³ C E Ford and S Harter “The Downside of Electronic Publishing: Problems in Accessing Electronic Journals through Online Directories and Catalogs” 36 *College and Research Libraries* 335 at 335. Available at <http://www.ala.org/ala/acrl/acrlpubs/crljournal/backissues1998b/july98/ford.pdf>

¹²⁴ Ibid.

¹²⁵ L Youst and H Koh “Management and Discovery of Electronically Stored Information” (1997) *Computer Law Review and Technology Journal* 73 at 75. Available at <http://www.smu.edu/csr/Youst.pdf>

¹²⁶ Joint Forum Consultation Paper above note 12 at 20; see also IR Web Report. IR is an online investor relations firm. They were established in 2000 and their website is available at <http://www.irwebreport.com/>. IR Report has been critical of SEDAR stating that information on SEDAR’s website is difficult to find.

¹²⁷ Although this comment was made in the context of mutual funds the same difficulties would present when seeking information on securities generally. Submission by Lang Michener. Available at www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part8/Comments/81-403/com_20030507_81-403_olsen.pdf at 2-3.

¹²⁸ IR Web Report above note 126.

¹²⁹ A CAPTCHA is a test devised to identify whether the user is a computer or a human. The word is an acronym for Completely Automated Public Turing test to tell Computers and Humans Apart. It is designed to distinguish genuine human users from web-crawlers or bots that are in essence computer programmes that gather web information. <http://en.wikipedia.org/wiki/Captcha>

¹³⁰ H Woodward, F Rowland, C McKnight, C Pritchard, J Meadows, “Café Jus: an Electronic Journals User Survey” Volume 1 Issue 3 *Journal of Digital Information* Article No 11, 1998-09-18 at part 4. Available at <http://jodi.ecs.soton.ac.uk/Articles/v01/i03/Woodward/>

¹³¹ Ibid at para 3.2.2.

it may still be difficult to read documents where the amount of text available on the screen has been reduced.¹³³ Moreover, studies and surveys indicate that readers resist reading lengthy information from a computer screen.¹³⁴ Investors may therefore decide to print out material, transferring the cost of printing from the company to the investor. Cumulatively these factors may provide further obstacles to all but the most dedicated investor reading documents accessed via SEDAR.

The final problem that has been identified relates to outages. The Joint Forum Consultation Paper draws attention to the unambiguous fact that system outages deny access and clearly outages should be kept to a minimum.¹³⁵ The damage that outages can cause has been the subject of comment by IR Report that noted the extent of difficulties of access occurring in April 2001 following reconfiguration of the public section of SEDAR's website. Technical problems resulted in thousands of hyperlinks returning "404 error" messages. For those Canadian companies that had provided links from their Investor Relations sites to SEDAR, it meant that the links did not work and some remained broken for many months. This is a significant problem when it is kept in mind that SEDAR receives upwards of an estimated 150 million hits a month.¹³⁶

So while SEDAR is an enormously valuable resource for the Canadian securities and financial markets, the overall conclusion must be that if greater reliance is to be placed on electronic transmission of securities information in Canada, SEDAR must be improved to make it more reliable and user-friendly. It must operate in a manner that ensures it provides easy access to information rather than creating barriers or obstacles.

v. Delivery Versus Access

Much of the debate in Canada and the U.S. about the electronic transmission of securities information, has been couched in terms of a choice between delivery of documents to investors, or allowing them to access them directly, primarily through the Internet. This framing of the issue, overlooks the fact that a great deal of information is already transmitted to the market through access arrangements (primarily by filing on SEDAR) and not by delivery. This trend has become ever more prominent with the growth of

¹³² Ibid at para 3.2.3.

¹³³ Ibid at para 3.2.2.

¹³⁴ Ibid at part 4.

¹³⁵ Above note 126 at 20.

¹³⁶ D Jones for IR Report "Avoiding linkrot on your website" Available at <http://www.irwebreport.com/features/010703.htm>

continuing disclosure by corporations, as discussed in Section i. In Canada, as in other countries, there are many continuing disclosure documents that must be filed and are accessible, but are not required to be delivered to security holders.¹³⁷ There are others where after filing delivery to the security holder is required only on request.¹³⁸ In some cases the SEDAR filing must be accompanied by a news release.

All of the information in these documents is relevant to security holders, yet why is it not required to be delivered? This is a particularly trenchant question, when it is realized that dispensations are given from including content in an issuer's subsequent short-form prospectus are granted on the basis of filed documents incorporated by reference, but not delivered to security holders. Canadian securities regulation already contains significant aspects that require prospective and current investors to take an access approach to transmission of securities information, rather than requiring delivery. Implicit in this is the assumption that in order to access SEDAR, the vast majority of investors must have access to a computer - if not their own computer, then through their broker. If regulation is to continue to require delivery of some documents, then surely we must have clear policy arguments for maintaining that requirement. These are considered in the next two sections.

vi. Difficulties With Electronic Delivery

Following from the discussion of electronic delivery above, it is of note that, despite NP 11-201's potential for reducing the burden on reporting issuers with respect to paper document delivery, the securities regulators recommend that deliverers make a paper version of every document delivered by electronic means available at no cost to a recipient upon request by such recipient, regardless of the form in which the document was originally delivered. Moreover, with respect to the required form and content of electronic documents, subsection 3.1 (2) of NP 11-201 requires the current paper version to be recreated in electronic format (instead of simply being scanned into electronic format). Both of these points tend to undercut the effectiveness of NP 11-201 for reducing the use of paper-based delivery by reporting issuers.

More intractable are the difficulties surrounding the proof of delivery: in particular, obtaining security holder consent to electronic delivery, as the central way of proving that delivery has been achieved. What evidence there is suggests that it is quite difficult to solicit security holder consents, particularly consents

¹³⁷ For example, Annual Information Form, Material Change Reports, Business Acquisition Reports and Material Contracts Reports.

¹³⁸ Annual and Interim Financial Statements and Auditor's Report and Management Discussion and Analysis.

that involve giving an e-mail address.¹³⁹ In the U.S., where electronic delivery is becoming familiar but is far from universal, the pattern is for companies to solicit consents when they send paper documents, or through using the services of an electronic delivery agent such as ADP's Investor Communications Services division.¹⁴⁰ The company or its electronic delivery agents send e-mail notices to consenting shareholders giving them notice that its proxy (or other) documents have been posted on a website. Where e-mail addresses have not been obtained, a post card may be sent in the mail, providing notice of the website posting. In all cases, effective delivery will only have been affected if the documents are of the type the security holder has consented to accept electronically, the electronic media used in delivery are according to the consent¹⁴¹ and the document actually obtained by the security holder is the same as that sent. In Canada it seems that consent may not be implied¹⁴² – for example, when a security holder supplies their e-mail address to a company in another context, or where there is a course of communication with the security holder from which it would be reasonable to imply that e-mail might be used for notice, and that other common electronic media such as a website might be used for access. Similarly, consent cannot be implied from the issuer providing a paper notice that it will deliver documents electronically in the future, specifying the medium and the process, to which the security holder does not object.

The obstacles to implied consent are best seen in the context of delivery requirements owed by the broker to its customer. Even if there were an online investing customer agreement in place the operation of which is only possible if the customer has computer access to the broker's site and contractually stipulates electronic communication, a prescribed consent under NP 201-11 would still likely be required. Consent could not be implied from the entirely online nature of the broker/customer account. However, the consent obtained could be the agreement by the customer to browse their account on the broker's website regularly, saving the need for the broker to deliver trade confirmations and account updating documents.

There is an important distinction to be made between the distribution of the prospectus, and ongoing notices such as proxy statements, once the investor has become a security holder. Clearly the greatest savings from soliciting consents for electronic delivery accrue in relation to the ongoing status of security holder. Further the liability for failure to deliver may not be as great as in relation to a selling document

¹³⁹ Broc Romanek and David Lee, 'E-Communication to Shareholders Outside the Offering Process', *University of Toledo Law Review*, 37(1) in press.

¹⁴⁰ Ibid. See also <http://www.icsdelivery.com/live/>

¹⁴¹ Including the technical requirements for retrieval and software requirements for viewing, Above note 45 CSA National Policy 11-201 - *Delivery of Documents by Electronic Means*, Appendix A, Sample Consent Form.

¹⁴² Above note 45 para 2.1(5).

like a prospectus. But it is the ability of the issuer to enlist the assistance of intermediaries in whose name securities might be held, to obtain the e-mail address and consent to electronic delivery, of the beneficial owners (i.e. the real owner who is entitled to vote their shares on the proxy issues) that may be the greatest assistance. It may be for these reasons that in the U.S. it is in the area of ongoing document delivery obligations that the real advances have been made in terms of electronic delivery. One commentator has observed that over a recent proxy season “roughly 4,500 companies used some level of electronic delivery”.¹⁴³ This has encouraged electronic delivery agents such as ADP Investor Communications Services to establish websites where security holders are encouraged to register their e-mail addresses and consent to electronic delivery, augmenting the other ways in which such details are solicited.¹⁴⁴

Obtaining consent is more difficult and electronic delivery less likely to provide savings, in relation to prospectuses. If the prospective investor does not become a security holder, then the cost of obtaining consent is thrown away. Further, the justification for requiring express consent (as opposed to implying consent from the pre-existing use of electronic communication) may be less, since most prospectuses (and other selling material) are likely forwarded to the investor by their advisor, with whom they will very often already have a channel of electronic communication. These arguments would suggest a relaxation of the express consent requirement.

Indeed, as has been discussed above, it is not electronic delivery itself that is the difficulty, rather, it is the need to obtain express consents that is the current hurdle to electronic delivery. As with the discussion of the purposes of disclosure in Part 4, in considering consent and delivery it is really the position of retail investors which concerns U.S.. What is the purpose of express consent from retail investors? To what degree will the purposes of disclosure which delivery supports, be defeated, if express consent is not required? The arguments for express consent hinge on ensuring the reality of access in all the dimensions in which it is discussed in Part 5 – physical access, the quality of access and ensuring that the capacity of the site can ensure access. Express consent also provides for notification that information is available. It communicates the Internet location of the information to be transmitted.

¹⁴³ Above note 139.

¹⁴⁴ For example, <http://www.icsdelivery.com/live/> Also some corporations are doing this directly – see www.rmhc.org/corp/invest/share/edelivery_annual.html where McDonald’s Corporation encourages shareholders to sign up for electronic delivery of Annual Meeting materials by promising to contribute one dollar towards the planting of trees, for every shareholder who supplies details consenting to one of several modes of electronic delivery.

Here again, as already discussed, the main difficulty is not with ongoing security holder communications, but with the sale of new securities. However, matters might be easier than they at first appear. With prospectuses the notification issue is likely to be dealt with because the issuer's selling and distribution team will publicize the fact of the issue. The availability of selling documents is likely to be drawn to the investor's attention, without the requirement for formal notification inherent in express consent. It is easy enough to provide that a URL to a prospectus be included in all publicity.

The more testing question is that of ensuring the reality of access to the prospectus. A major difficulty encountered by retail investors is access to long documents. It is also clear that from the research on whether and how investors read prospectuses, long documents are of little value. One response to the access problem, which is advocated further below for other reasons too, is to reduce dramatically the length of retail investor selling documents. Documents of only a few pages would likely avoid most access problems. As for the dimension of access which relates to site capacity, if the site to which access is to be provided is SEDAR, then this implicates more general questions, which will not be solved by whether or not there is a requirement of express consent for electronic delivery. In summary, there are good reasons for rethinking the requirement for express consent, at least in relation to selling documents.

vii. Why Should the Default Medium be Paper?

Another obstacle to the realization of the benefits of electronic transmission of securities information is the need to print sufficient paper copies of prospectuses to be able to supply these on request. At present this is necessary because express consent requirements have made electronic delivery of prospectuses relatively difficult. However, rethinking consent and delivery along the lines suggested in this report, should mean that there are many fewer requests for paper prospectuses and that those which would still need to be delivered, would be very greatly shorter. It is inevitable that since the Internet is not available to everyone, paper delivery is with us for some time yet. However, should it continue to be the default medium?

Now an investor will often be sent electronic selling material by their broker, or if a self-directed online investor, will find it alone. Most could access an online prospectus if the URL was on selling material sent by their broker, or would find it alone if an independent investor. If a paper document is required, could it not be the form of disclosure that must be requested, for those who either permanently or temporarily have inadequate or no computing? Or by those who prefer to deal entirely by phone or in

person with their broker or just like to read a paper document? Would such a change produce a very great mischief? It is difficult to imagine what that mischief would be.

viii. Recommendations

Recommendation #3: If greater reliance is to be placed on electronic transmission of securities information in Canada, SEDAR must be improved to make it more reliable and user-friendly. It must operate in a manner that ensures it provides easy access to information rather than creating barriers or obstacles.

Recommendation #4: Reconsideration should be given to the requirement of express consent to electronic delivery, so long as access to and integrity of the delivered document is assured (e.g. because the document is very short).

7. **Alternatives to ‘Delivery’ in Securities Information Transmission.**

As the reader will have seen, the thrust of this report is to consider – a decade after the commercial introduction of online retail investing – whether the restrictions thought necessary then, are still required today. So it has been important to reconsider the elements of express consent and the place of the paper prospectus as the default medium of delivery. A second angle has been to consider the purposes of disclosure, and the degree to which electronic transmission of securities information supports those purposes. In particular, the fact that there is a great deal of continuous disclosure, and that much of this is not delivered has been noted. So has the fact that although more investors than is commonly thought attempt to read prospectuses (and one assumes proxy documents etc), they find them indifferently helpful in decision-making, and too long. Finally, if electronic transmission is to be promoted, there is a need to take stock of deficiencies in the operation of SEDAR. This last point is of course the key to the success of many of the alternatives to delivery that are now canvassed. Without SEDAR, or some other system (such as the heavy use of investor relations sites of reporting issuers as in Australia) most of the suggestions made below, could not be operationalized.

i. Extensible Business Reporting Language (XBRL).

XBRL is a language for the electronic communication of business and financial data. It is derived from Extensible Markup Language (XML), the primary purpose of which is to facilitate the sharing of data across different systems or programs, especially those connected via the Internet.¹⁴⁵ XBRL is a variant particularly adapted to business reporting. XBRL allows the “tagging” of data items. That is, information is included in the text which allows an item of data to be identified by the computer (for example, company net profit would have its own unique tag). This is done according to “taxonomies”, which are agreed standards to allow detailed items in business reports to be identified in the same way. When this is done computers can recognize particular items of data, e.g. company net profit, and can select it, analyze it, store it, exchange it with other computers, all in a fashion that is useful for particular users. The tagging of data allows the processing of data through interchange with different programs, without the cost and risks of error involved in re-keying information.¹⁴⁶

¹⁴⁵ Wikipedia at <http://en.wikipedia.org/wiki/XML>

¹⁴⁶ XBRL, ‘An Introduction to XBRL.’ <http://www.xbrl.org/frontend.aspx?clk=LK&val=20>

XBRL¹⁴⁷ does not set new accounting standards; rather, it expresses aspects of existing standards electronically and in an organized manner. XBRL does not define financial accounting or reporting concepts; it expresses those concepts electronically, so that individuals and computers can understand them and use them. An XBRL taxonomy is a way to map an internally used chart of accounts to common terms used externally, thus promoting comparability between reporting entities. Finally, XBRL is not a programming standard or tool. It is a standard for tagging items in a database. To generate a report, a report generating program has to be used - it is not the case that XBRL generates analyses or reports - it simply allows the common identification of data items that can be imported into such analysis and report generating programs.

There has been great enthusiasm expressed for the prospects of XBRL, though to date there is relatively restricted use of the language in business reporting in fact. An important boost for the adoption of XBRL is the SEC's voluntary program for reporting financial information on EDGAR using XBRL.¹⁴⁸ This program has now been extended to mutual funds as well as corporations.¹⁴⁹ This should have the benefit of allowing companies to collect their data into the XBRL format for internal purposes, and then relatively easily import that data into the formats required for other types of reporting, including that required by the SEC. In turn, investors should be able to integrate the information disclosed into their own analyses, testing it for comparison with other companies and with their own investment criteria or benchmarks. At present, to achieve this, information would have to be manually located from SEC filings, and keyed into the investor's own analysis programs. The SEC and the promoters of XBRL hope that this ease of analysis will strengthen financial management, internal and external reporting and corporate governance, as well as improving investment decision-making.

Amid the enthusiasm, it is necessary to bear in mind the limitations to XBRL. The first is raised by the necessity to create taxonomies, to allow meaningful comparison of like data items by one organization with another. The creation of taxonomies for data as complex as that required by accounting standards or regulatory reporting systems is difficult and time consuming. There are limited resources for this work.

¹⁴⁷ In this paragraph I rely heavily on the description and terms used by Chartered Accountants in England and Wales 'Information for Better Markets Digital Reporting: a Progress Report' (September 2004) at p22-23. Available from http://www.icaew.co.uk/index.cfm?AUB=TB2I_71013%7CMNXI_71013

¹⁴⁸ C Cox, 'Speech by SEC Chairman: XBRL Conference' 18 January 2006 at <http://sec.gov/news/speech/spch011806cc.htm>; SEC, 'SEC Offers Incentives for Companies to File Financial reports with Interactive Data' 11 January 2006 at: <http://www.sec.gov/news/press/2006-7.htm>; SEC, List of Companies Submitting Data in the XBRL Voluntary Program on EDGAR, 20 September 2005, at: www.sec.gov/Archives/edgar/xbrl.html; SEC 'XBRL Voluntary Financial Reporting Program on the Edgar System' 17 CFR Parts 228, 229, 232, 240, 249 and 270, 16 March 2005.

¹⁴⁹ 'SEC XBRL Voluntary Program Extends to Investment Companies' 8 August 2005 at: <http://www.sec.gov/news/press/2005-112.htm>

Further XBRL is extensible, that is, it allows the creation of tags that increase the level of reporting detail by customizing reporting to an organization's own circumstances. The difficulty is that it adds to existing complexity, and some organizations might extend in areas where others do not, hence reducing the degree of comparability that might be obtained. Further, if organizations do not understand or do not adopt standard taxonomies (e.g. they use 'fee income' not the term 'revenue' which is in the standard taxonomy), then again, comparability is compromised. Also where tags are duplicated like this, it opens the possibility that investors will be confused or misled, and their analysis will be faulty.¹⁵⁰

Another limitation on the prospects of XBRL is the small number of organizations actually reporting in this language. Although it may be very beneficial for those organizations who have adopted it, XBRL will only realize its potential when many organizations use it. It is true that a number of important governmental organizations, such as the SEC, have promoted the use of XBRL through voluntary filing programs. Still the benefits, especially for market analysts and investors, will only be realized when there are sufficient users that investment decisions can be made after the analysis of XBRL disclosure of a number of organizations.¹⁵¹ At the moment, XBRL is limited in its coverage and at an early stage of development.

Auditing practice may have to develop further in order properly to verify XBRL reporting. There are also some technical hurdles which require attention, for ensuring the stability and security of data reported using XBRL. Extrapolating from some studies of Internet reporting done in PDF and HTML formats, we can see that there are some matters that need to be considered before there can be reliance on this means of reporting.¹⁵² There needs to be greater attention to the security of data presented in digital formats, as this is more easily altered. The presentation of paper accounts is accompanied for the purposes of integrity and authentication by a signed audit certificate. For the reasons given above in the discussion of digital signatures this is more difficult, when the financial disclosure is all accomplished in a digital format such as XBRL. A study of more conventional digital reporting observed the frequent absence of the signed audit certificate, leaving uncertain the degree to which disclosed financial reports have been given a clean bill of health by auditors.¹⁵³ Relatively straightforward techniques of cryptography could be used to address this difficulty.

¹⁵⁰ Price Waterhouse Coopers response to SEC Concept Release: *Enhancing Commission Filings Through the Use of Tagged Data*, 23 November, 2004. Available at <http://www.sec.gov/rules/concept/s73604/price112304.pdf>

¹⁵¹ Above note 147 at 3.

¹⁵² J Viao, M Jones & A Lymer 'A Conceptual Framework for Investigating the Impact of the Internet on Corporate Financial Reporting' (2005) 5(10) *The International Journal of Digital Accounting Research*, passim; Above note 5 Fisher, Oyelere & Laswad at 26.

¹⁵³ Above note 5, Fisher Oyelere & Laswad at 418-20.

The same study also observed the selective omission or publication of excerpts from audited financial statements especially by companies that had received going concern modifications in their auditor's reports, and the "blending" on websites of audited and unaudited information.¹⁵⁴ That research also raised questions about the use of hyperlinks to other websites in disclosed material, which could introduce ambiguity about whether material was authored by the disclosing corporation. This suggests that auditors will have to mandate with management the conditions as to document integrity and security of digital disclosure, or that securities regulators do so.

Advocates of XBRL assert that its adoption will lead to greater transparency in financial reporting. This is debatable. Greater transparency implies the disclosure of additional information, but there is nothing to suggest that corporations will report more than they already do, and more than they are required to, just because they use XBRL. It is true that investors may be able to analyze data more thoroughly when it is presented in XBRL format, but this is likely to apply mostly to analysts and professional investors. Although the research discussed above regarding investor use of prospectuses is more encouraging than often thought, it is very clear that most individual investors do not dig very deeply into disclosed information.¹⁵⁵ It is relatively unlikely that disclosure in XBRL format will alone change that; indeed, it may provide a further obstacle, because investors will have to be both computer and financially literate in order to take advantage of disclosure in this format.

Finally, XBRL may have the effect of over emphasizing financial as opposed to more general business reporting. XBRL is an approach to reporting that is characterized by an emphasis on frequency and a data orientation rather than information and interpretation. XBRL reporting can only ever capture material that can be digitized - it is much less good for narrative reporting relating to strategy, governance and sustainability - where human judgment enters and where values must be applied.¹⁵⁶ It is no surprise as Langevoort points out, that management discussion and analysis is becoming the explanatory "bridge between reported results and economic reality so that issuers risk being in violation if they conceal whatever is creating the difference".¹⁵⁷ Technology may be dangerous and regressive, if it has the effect of distracting from these important aspects - "decisions of investment, analysis and management not always based on formal reporting, but on knowledge, information, hypotheses and intuitions"¹⁵⁸ - ideas

¹⁵⁴ Ibid.

¹⁵⁵ See discussion surrounding notes 11 to 28 above.

¹⁵⁶ Above note 147 at 34.

¹⁵⁷ D Langevoort 'Technological Evolution and the Devolution of Corporate Financial Reporting' (2004) 46 *Wm and Mary Law Review* 1 at 23.

¹⁵⁸ Ibid at 34.

that cannot be reduced to an XBRL taxonomy. Finally, while XBRL reporting may augment the financial aspects of disclosure, it can never replace selling documents or proxy statements, which address other sorts of information and discussion. In summary then, while we may look forward to the development of this second and more technologically sophisticated level of digital disclosure, it is necessary to take a disciplined approach to what it can actually achieve.

ii. A “Duty to Browse”

The sale of securities is sometimes seen as a species of e-commerce more generally.¹⁵⁹ For that reason, and because general e-commerce law has developed to deal with particular legal uncertainties thrown up by the Internet,¹⁶⁰ it is worthwhile to consider the relevance of some of these changes to document transmission in the online investing context.

An approach, potentially useful in securities law, has been developed in relation to “clickwrap” contracts. These are contracts made over the Internet, where at least in theory¹⁶¹ the purchaser reads the terms and then clicks on an “I agree” button or does something else to indicate intention to enter the contract. In *Rudder v Microsoft Corporation*¹⁶² a foreign choice of forum clause was enforced against a plaintiff who had entered a Microsoft Network (MSN) agreement by clicking on an “I Agree” button presented on the computer screen at the same time as the terms of the member agreement. The court rejected the argument that the foreign choice of forum clause was not part of the contract and was analogous to “fine print” which Microsoft should have drawn to the customer’s attention. The fact that the clause was not on the screen, but could have been displayed if the scrolling function had been used, did not disqualify it as a term of the contract.

This approach has been extended where courts have allowed Internet service providers to rely on unilateral variations of an agreement (including an arbitration clause), when this has been notified to the customer by posting the change on the service website.¹⁶³ In cases such as such as *Kanitz v Rogers Cable*

¹⁵⁹ Above note 72 chapter 24.

¹⁶⁰ Above note 72, chapter 19; Yee Fen Lim, *Cyberspace Law*, (OUP 2002), Ch 3; Margaret J Radin, John A Rothchild & Gregory M Silverman, *Internet Commerce - The Emerging Legal Framework*, (Foundation Press, 2002) Ch 4.

¹⁶¹ But as Geist points out, ‘As a result of the implementation of many Web interfaces, it is frequently difficult or even impossible to ascertain the terms of clickwrap contracts.’ Above note 51 at 598.

¹⁶² *Rudder v Microsoft Corporation* [1999] OJ No 3778 (Sup Ct).

¹⁶³ The agreement between the customer and service provider provided that notification by posting on the website and by e-mail would be sufficient.

*Inc*¹⁶⁴ the agreement between the Internet supplier and customer as held by the court was “to place an obligation on the customer, who is interested in any amendments that the defendant may choose to make ...to check the website from time to time to determine if such amendments have been made”.¹⁶⁵ The court pointed out that as those taking on an Internet subscription are those who wish to use the electronic mode, it does not seem unreasonable for subsequent contractual communications to take place by that means. The court went on to elaborate this obligation making it clear that the customer may have to search through to find the right part of the service website.

This approach is different from the “access-equals-delivery” idea, discussed below. With access there has to be some contemporaneous notice of the posting, however indirect. Where there is a “duty to browse”, the customer is bound by the terms of the initial agreement, to browse or review the supplier’s site to familiarize themselves with new contract terms, or in our situation, new securities information. In the contract situation they should do this before every renewal of the agreement, as express renewal - or possibly indirect acts such as payment for a future term - likely evidences acceptance of the new terms whether or not they have been reviewed.¹⁶⁶

Securities regulators have not embraced arrangements along the lines of a duty to browse. Even suggestions that consent to electronic delivery be implied have not been accepted,¹⁶⁷ let alone a full duty to browse. The closest they have contemplated is that an express consent might evidence the agreement of the security holder to “monitor the deliverer’s website on a regular basis, thereby eliminating any need for the deliverer to provide separate notice to the recipient”.¹⁶⁸ In the Canadian context if such a consent were given, it would likely be to review the issuer’s site, and follow the links to recent postings by the issuer on SEDAR.

What are the policy implications for such a move in the transmission of securities information? Clearly an agreement to monitor an issuer’s website regularly is something that could only be obtained against the background of the ongoing connection of issuer and security holder – it could really only operate to get security holders to keep up to date with company affairs after they have become investors. It will not

¹⁶⁴ *Kanitz v Rogers Cable Inc* (2002) 58 OR (3d) 299.

¹⁶⁵ *Ibid* at par 24, page 307.

¹⁶⁶ Clearly there are some limits: agreement to terms which make consideration illusory or are against public policy would not be possible whether or not the customer did acts accepting them.

¹⁶⁷ Securities and Exchange Commission Release No 33-7233;34-36345, 6 October 1995, examples 1, 3, 23 and the emphasis on express consent throughout Canadian National Policy 11-201 - *Delivery of Documents by Electronic Means*, especially Appendix A, Sample Consent Form. See above note 45.

¹⁶⁸ Above note 45 para 2.2(3) & (4).

provide assistance in relation to the transmission of prospectuses. In order to be politically acceptable to investors and operational in practice, it is likely that alongside a duty to browse, the company would have to contact its shareholders from time to time. This means that it would still have to collect and keep up-to-date a database of contacts. Indeed, unless the law was changed, the company would still have to seek express consent to electronic delivery of certain documents. Imposing a duty to browse through a company constitution would not alone be enough to reform the current law: it would have to be done through legislation, with accompanying alterations to the existing rules about express consent and delivery.

While it would likely reduce costs to adopt a legislative duty to browse, possibly the most important consideration is whether it reduces the quality of deliberation within companies. Even with the delivery of proxy statements and other ongoing disclosure to security holders, it is difficult to get more than a small minority galvanized to participate in company affairs and to attend, speak and vote at meetings. By requiring investors to seek out company documents, the duty to browse may mean that they do so less and that the quality of security holder supervision of governance in companies is reduced. So, while it has attractive aspects, a duty to browse is at best a partial solution (it could not apply to selling documents); may be politically difficult for companies to implement; and goes against the grain of current moves to invigorate security holder participation in companies.

iii. Access to Documents

In the securities market, setting access to documents generally means that they are available on the World Wide Web, over the Internet. The access model does not involve the obtaining of consents, though usually some form of notification is given. As the access model has mostly been used in the distribution of prospectuses, there is a commercial imperative to bring the document to general notice, through the media and advertising, the activities of the issuer's underwriter and broker, and so on. Documents available in this way are generally in PDF format, or HTML, but the practice that has been explored in the U.S. of using multi-media prospectuses and other 'free-writing' selling documents, opens up possibilities of multi-media (sound, moving graphics, video, interactive features) documents. This extends the formats in which documents might be delivered. That in turn opens up questions of equality of access to information, as not all investors may have programs that can realize these formats.

Australia has moved to a model where, at least in relation to the prospectus, the issuer now has an obligation to make the document generally available, but not to deliver it. In the securities regulation

reforms adopted in 2005, the U.S. has moved in the same direction, but only in relation to the final prospectus. The preliminary prospectus, where required, must still be delivered.¹⁶⁹ At the same time the U.S. moved to relax its restrictions on the publication of material for promoting the issue. It now permits the use of “free-writing” prospectuses. The degree of this relaxation depends upon how “well-seasoned” or how “well-known” the issuer is to the market.¹⁷⁰

Until the recent U.S. securities reform proposals, it was the case that other aspects of Australian regulation of the offering process actually provided greater scope for the easy use of electronic documents and “free-writing” material. In Australia, no offers or invitations for securities may be made until a prospectus has been lodged with the Australian Securities and Investments Commission (ASIC).¹⁷¹ This equates with the U.S. and Canadian pre-filing period.¹⁷² The “exposure period”¹⁷³ follows, during which the issuer may make offers and invitations but may not accept them.¹⁷⁴ This period lasts 14 days. ASIC does not vet prospectuses during the exposure period. Instead it relies on selective compliance reviews¹⁷⁵ and the receipt of complaints or tip-offs from analysts, commentators, journalists and members of the public.¹⁷⁶ During the exposure period, ASIC places great importance on the issuer taking steps to make the prospectus generally available - such as by placing the prospectus on a website and using publicity and communication that is likely to be seen by those interested in the securities to be issued.¹⁷⁷ While in Canada and the U.S. there have been strict controls on publicity, advertising and making of offers or invitations for securities prior to finalization of a registration statement, in Australia during the exposure period and thereafter the only real restriction is that advertising must include a statement that the offers of

¹⁶⁹ Friedman, above note 110.

¹⁷⁰ Friedman, above note 9 at Ch3 and above notes 10 and 47.

¹⁷¹ Offer is construed widely by the Australian courts and is not limited to a technical or contractual meaning. It also includes the distribution of material that would encourage a member of the public to enter into a course of negotiations calculated to result in the issue or sale of securities: *Australian Softwood Forests Pty Ltd v A-G for New South Wales* (1981) CLC 40-734; *A-G for New South Wales v Australian Fixed Trusts Limited* [1974] 1 NSWLR 110.

¹⁷² J F Olsen & H L Pitt *Securities in the Electronic Age: A Practical Guide to the Law and Regulation* (Glasser Legal Works, 2000) 2-36.

¹⁷³ ASIC, Policy Statement 152, *Lodgement of Disclosure Documents*, 07/06/2000, para 152.1. Available [http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ps152.pdf/\\$file/ps152.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ps152.pdf/$file/ps152.pdf)

¹⁷⁴ Section 727(1) & (2) *Corporations Act 2001*, though the ‘exposure period’ may not apply if the securities to be issued are already quoted.

¹⁷⁵ Above note 173 para 152.46-49.

¹⁷⁶ Above note 173 at para 152.21 and *The Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998*, para 8.68. Available

http://parlinfoweb.aph.gov.au/piweb/view_document.aspx?ID=311&TABLE=OLDEMS

¹⁷⁷ Above note 173 at para 152.03 and 152.04.

securities are made in the prospectus¹⁷⁸ and that anyone wishing to acquire the securities will need to fill in the application form which is “in or will accompany the disclosure document”.¹⁷⁹

There is a legislative requirement that for all offers for securities, an application form is “included in the prospectus or accompanied by a copy of the prospectus.”¹⁸⁰ This and the relative freedom in relation to advertising from the time of lodgment of the prospectus are leading reasons why considerable importance has been placed on means to ensure that the investor receives the prospectus before or at the same time as the application form, in an electronic prospectus,¹⁸¹ and that electronic promotional material is published in such a way that a reasonable person would not confuse it with the prospectus. While an application form will usually be part of a paper prospectus, such a physical connection cannot be relied on in the electronic domain. ASIC suggests that the application form is made part of the same electronic document file as the prospectus, or that other electronic means are used to ensure that investors can access the prospectus only if they have the application form or that the issuer can verify that the investor received the application form first.¹⁸² Similarly, ASIC encourages issuers to use a separate electronic file for each of the prospectus and promotional material. Also, while there may be hyperlinks from advertising and promotional material to the prospectus, there may be no such links from the prospectus to advertising.¹⁸³

From this discussion the reader will see that Australia has resolved the regulatory question about whether the issuer should deliver the prospectus¹⁸⁴ or make the prospectus available, in favour of availability or accessibility. Assurance that the investor has made the investment decision on the basis of the prospectus is given by requiring that issuers only accept applications for securities made on an application form that

¹⁷⁸ Section 734 (2) *Corporations Act 2001*. Also ASIC, Policy Statement 158, *Advertising and Publicity for Offers of Securities*, 17/02/2000, available

[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps158.pdf/\\$file/ps158.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps158.pdf/$file/ps158.pdf)

¹⁷⁹ Section 734 (4) & (6) *Corporations Act 2001*. Also no applications can be accepted or given precedence during the ‘exposure period’ (see note 173 above para 152.60-73) and statutory provision is made for the holding of application monies on trust, section 722 *Corporations Act 2001*.

¹⁸⁰ Section 727(2) *Corporations Act 2001*.

¹⁸¹ Section 727(2) *Corporations Act 2001*, ASIC Policy Statement 107 *Electronic Prospectuses*, 10/02/2000 available [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps107.pdf/\\$file/ps107.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps107.pdf/$file/ps107.pdf); ASIC Policy Statement 150 *Electronic Applications and Dealer Personalised Applications* 5/7/2000 available [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps150.pdf/\\$file/ps150.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps150.pdf/$file/ps150.pdf), both as developed by ASIC Class Order CO 00/44 *Electronic Disclosure Documents, Electronic Application Forms and Dealer Personalised Applications* 14/2/2000; (class orders in 2000 are not available online but are available from ASIC Gazette) up-dated by ASIC Class Order, CO 02/261, 02/2002 *Electronic Disclosure Documents, Electronic Application Forms and Dealer Personalised Applications - Amendment*. Available [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/co02-261.pdf/\\$file/co02-261.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/co02-261.pdf/$file/co02-261.pdf)

¹⁸² ASIC Policy Statement 107 *Electronic Prospectuses*, above note 181 para 107.51.

¹⁸³ *Ibid* para 107.86.

¹⁸⁴ Until very recently under U.S. law, even in the electronic environment, the prospectus had to be delivered and the issuer had to be able to verify this - Friedman above note 9 at 2-1 -18; Olsen above note 172 at 2-21-26.

the issuer can assure ASIC was available with or in the prospectus. Indeed this is a technique that has been considered by the SEC.¹⁸⁵ ASIC suggests a number of ways this assurance can be given: the use of warnings that the application form can only be used if the prospectus has also been provided; if the application form can only be accessed by hyperlink from the prospectus; if the investor must sign an acknowledgement of receipt of the prospectus on a print-out of the application form; or on an electronic form enter a personal identification number next to such an acknowledgement.¹⁸⁶

The gap between regulation in the U.S. and Australia has now reduced, given the SEC's 2005 securities offering reforms. These reforms allow issuers and their agents to use "free-writing prospectuses", and this will do much in both legal and practical terms to free up the use of non-proscribed material in the U.S. offering process. In fact the U.S. reforms go further than Australia, because now in the U.S. only unseasoned and non-reporting issuers have to ensure that investors have a statutory prospectus in their hands, prior to or contemporaneously with the free-writing material, whereas all issuers must do this in Australia.

Under the 2005 U.S. changes, seasoned and well-known issuers must simply include a legend on their selling material that there is a statutory prospectus available, and include the electronic address in EDGAR, or the URL for another website where it may be accessed.¹⁸⁷ Investors are presumed to have access to the Internet and the obligation to transmit a final prospectus may be satisfied by filing the final prospectus with the SEC, and its subsequent availability to investors through the SEC's EDGAR database.¹⁸⁸ It could also be made available by posting on another site on the Internet. The difference between the U.S. and Australia in this regard, is quite crucial. The operative provisions of the Securities Act 1933 have resulted in a practice of making the final prospectus available to investors when the securities are delivered or their sale confirmed.¹⁸⁹ As in Canada, the final prospectus is not a guide to the investment decision (though other permitted documents such as the registration statement, preliminary prospectus or term sheets might be). Rather, it "tells the investor whether he has acquired a security or a law suit."¹⁹⁰ For these reasons, the SEC considers the greatest utility of the final prospectus is as one

¹⁸⁵ Above note 73 Release No 33-7233 (Oct 6 1995) at Section II.B.

¹⁸⁶ ASIC Policy Statement 150 above note 181 para 150.27-33.

¹⁸⁷ Friedman above note 9, 3-21 to 3-25 esp 3-23.

¹⁸⁸ For example, rule 172 (para 230.172), Securities and Exchange Commission, Securities; Final Rule, 17. Above note 10.

¹⁸⁹ Ibid Sections 10(a) and 5(b)(2) Securities Act 1934, as explained at pp 67437-8.

¹⁹⁰ L. Loss & J. Seligman, *Securities Regulation*, section Offering Reform 2-b-3 (3d ed. 2001). Little Brown and Co New York.

“which informs and memorializes the information for the market”¹⁹¹ and that for this reason, there is no need to insist on actual delivery of the prospectus to the purchasers: access will be sufficient. In Australia, by comparison, the statutory prospectus is required to precede or accompany an invitation or offer for sale of securities. As a result, while Australia has for some time had an access not delivery approach to getting prospectuses into the hands of investors, ASIC has taken great care to ensure that as far as possible, the issuer makes the document available in a way that the application form which must be used, is accompanied by the prospectus.

iv. A Graduated Approach to Securities Information Transmission

Earlier discussion has pointed out the growth of continuous disclosure, instances of reform of prospectus procedures that allow greater publicity, and that much disclosure is already made in a fashion that doesn't involve the delivery of documents, or even the notification of the fact that disclosure has occurred. The filing of the Annual Information Form for an issuer with SEDAR¹⁹² is an example of this that we have considered.¹⁹³ If this is done, the regulation governing short-form prospectuses allows the incorporation by reference of the information that has already been put into the public domain by filing the Annual Information Form. The short-form prospectus requires delivery,¹⁹⁴ but unless the prospective investor visits SEDAR to look at the Annual Information Form filings, they never expressly consider this to be disclosed material. The ECMH which we considered earlier argues that they need not do so, for if the

¹⁹¹ Rule 172 Securities and Exchange Commission, Securities; Final Rule, 17.Above note 10. Part VI at 44782 of the Federal Register.

¹⁹² See text surrounding notes 98 and 99 above.

¹⁹³ Most Reporting Issuers can access the Canadian capital markets and issue securities by filing a short-form prospectus as provided by National Instrument 44-101 – *Short-form Prospectus Distributions* (“NI 44-101”). Eligibility for filing a short-form prospectus applies to all issuers listed on the TSX, Tier 1 and Tier 2 of the TSX-V and the Canadian Trading and Quotation System. In addition, to be eligible to file a short-form prospectus, an issuer must satisfy the following conditions:

- (a) the issuer must be an electronic filer under NI 13-101;
- (b) the issuer must be a reporting issuer in at least one jurisdiction of Canada;
- (c) the issuer must have filed, with the securities regulatory authority in each jurisdiction in which it is a reporting issuer, all periodic and timely disclosure documents that it is required to have filed in that jurisdiction;
- (d) the issuer must have, in at least one jurisdiction in which it is a reporting issuer, current annual financial statements and a current annual information form; and
- (e) the issuer's equity securities must be listed and posted for trading on a short-form eligible exchange and the issuer may not be an issuer whose operations have ceased, or whose principal asset is cash, cash equivalents, or its exchange listing.

The short-form prospectus is intended to be a slim document that incorporates by reference the reporting issuer's Disclosure Record and provides any update regarding the business, affairs and financial position of the Reporting Issuer since the date of its last continuous disclosure filing. The rationale is that certain disclosure, which is already publicly accessible by prospective purchasers on SEDAR need not be repeated in the short-form prospectus.

¹⁹⁴ Section 71(1) OSA.

markets in the stocks of Canadian issuers are informationally efficient, the already-disclosed information will have been taken into account in the discovery of the stock price, and further disclosure of the same information will usually be redundant.

This, and the fact that there have been a number of important reforms - including reform proposals that move away from the need for a traditional prospectus-¹⁹⁵ has provided the foundation for the following proposal of using the Internet for graduated disclosure. Along with suggesting a very abbreviated selling document, the adoption of this proposal would also require the repeal of requirements for express consent to electronic delivery. It would also require changing the time the selling document gets into the hands of investors, replacing these requirements with rules to make it likely that they will receive it before the investment decision is made. The proposal places reliance on intermediaries to promote this communication with potential security holders. This graduated approach would also allow the integration of disclosure in XBRL, as it develops and is more universally adopted.

The proposal develops that put forward by the Canadian Joint Forum of Market Regulators in its 'Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds'. Although the Joint Forum paper was written with retail investors in mind, as this report has shown, the really tricky questions about disclosure and its communication arise in relation to retail investors. Although this proposal starts with communication that is accessible to retail investors, this is simply a starting point for rethinking electronic communication of disclosure so that it meets the needs of investors more generally. The components and main changes needed to operationalize the proposal are as follows.

Foundational Disclosure Document

This is very short three-page foundational document that sets out the basic information about the security on offer and the issuer. The document should be "evergreen". It should be set out in a standard format, which will promote comparability between investments. It should list URL contacts for all the other sites where the investor may find authorised information about the investment. If it is transmitted electronically, it should contain hyperlinks to these other sites. The third page should be an application form which the investor must sign or submit using a PIN.

¹⁹⁵ See for instance SEC, Securities Offering Reform above note 11; Joint Forum Consultation Paper above note 12; National Instrument 44-101 *Short-Form Prospectus* above note 101; T Gray, A Kitching Reforming Canadian Securities Legislation, Parliamentary Information Research Service, 19th September 2005. Available <http://www.parl.gc.ca/information/library/PRBpubs/prb0528-e.htm>

This document should be disseminated to all investors by intermediaries in the selling process, who will not have fulfilled their suitability obligations, if they do not bring it to the investor's attention. The requirement to use the application form should also promote the document being read by self-directed investors.

The document is to be brought to the investor's attention before the security is sold (as the submission of the application form will require), and the current right of withdrawal or rescission from the investment should be repealed in consequence.

As the foundational document is very short, it may be passed on by the intermediary in almost any medium: it is not too long to fax, it could easily be e-mailed, it could be made available on a website, posted or given personally. For this reason there seems no need for the requirement for express consent to electronic delivery to be maintained, with the assurances of access that regulation implies. As for notification, this is addressed by placing the obligation on the intermediary to provide the document, and by requiring the application form be used.

The contents of the foundational document should be specified by regulation. In the prospectus reforms proposed in BC and the U.S., there is very considerable freedom to use 'free-writing prospectuses' or in other words, an infinite variety of selling documents. This proposal does not object to that course. However, it does consider that there is a clear and strong case for a single document that sets out authorised information, that the regulator considers every investor should know for his or her protection. This avoids the investor being over-loaded with material that they have to sift through to find the essential facts about their investment – that would simply be replicating in another way, the difficulties investors have identified with long prospectuses. The foundational document should not contain hyperlinks to other selling material, though all selling material should contain the URLs to all three of the documents described in this proposal, and hyperlinks if selling material is communicated electronically. Above all, the document must be kept short and simple.

Document Containing Issuer and Investment Specific Information

This, like the foundation document, should be very concise - 10 pages at most. It too, should be set out in a standard format, which will promote comparability between investments. Again too, it should be "evergreen".

It should contain information about the issuer, its business, its plans and prospects, its management and consequently, the prospects for the investment. It should describe the riskiness of the investment in a fashion that elaborates on the basic information in the foundational document. Again, the areas to be covered should be specified by regulation.

This document, though clearly authored by the issuer, should also be made available by the intermediary, and before the investment decision is made. It should underlie the intermediary's suitability recommendation, and provide a wider explanation to the customer of why the investment in question is being recommended. The proposal anticipates that an intermediary would review this document with a customer, before the investment decision is made. A self-directed investor would be alerted to it by the URL or hyperlink on the foundational document, which must be used to apply for the securities.

Continuous Disclosure Documents

The final graduation in the proposed disclosure scheme is that the previous two documents described should bear URLs or hyperlinks to locations where the issuer's continuous disclosure record is available. Almost all the material in the continuous disclosure record of a reporting issuer needs only to be filed with SEDAR (or SEDI) but need not be delivered to security holders. The exceptions are proxy statements, annual and interim financial statements, and auditor's reports, and the financial reports need only be delivered if the security holder requests it. Although some of this information is replicated in the current prospectus, research shows that retail investors do not gain much from it, even though many attempt to read it. Consequently, it seems reasonable that an access-equals-delivery approach be taken to disclosing this material to investors.

Financial intermediaries should draw the attention of investors to this material, and encourage them to consider it. There may need to be changes to the law to make it clear that in this level of disclosure, as well as that outlined in the previous two documents, security holders should have rights should there be any mis-statement or material error contained in them.

The focus of this graduated disclosure proposal has been on point-of-sale disclosure, as analysis shows this to be the most intractable in terms of obtaining consent for electronic delivery. It has been assumed that proxy statements and requested financial reports will continue to be delivered under current regulation – because the obtaining of consents is easier and more cost-effective where the security holder is ongoing. Alternatively, a similarly graduated scheme would be possible for proxy documents and

financial reports. Having such a scheme could completely remove the necessity for express consents, and the issuer or its agents may simply collect and keep up-to-date e-mail and other contact details, in order to notify security holders of meetings and availability of financial reports.

Finally, a graduated scheme would, over time, find a place for the sophisticated level of financial reporting that is implied by the capabilities of XBRL. There is no reason why, taking a cue from the SEC voluntary filing program, that Canadian regulators could not adapt SEDAR to accept filings in XBRL too. That would add an additional source of disclosure (though no additional information), benefiting professional investors while leaving retail investors with disclosure documents from which they too can derive benefit.

v. **Recommendations**

Recommendation #5: A foundational disclosure document of three pages in standard format should be disseminated to all investors by intermediaries in the selling process. The intermediaries will not be taken to have fulfilled their suitability obligations if they do not bring this document to the attention of the investors. The third page of the document should be an application form which the investor must sign or submit using a PIN.

Recommendation #6: A document containing issuer and investment specific information of 10 pages in standard format should be made available to by the intermediary to the investor. A self directed investor would be alerted to it by the URL or hyperlink on the foundational document, which must be used to apply for the securities.

Recommendation #7: The foundational disclosure document and the document containing issuer and investment specific information should bear URLs or hyperlinks to locations where the issuer's continuous disclosure record is available.

8. Conclusion

The thrust of the proposals in this report is to identify a disclosure scheme that builds on existing developments and takes advantage of the potential for electronic transmission of securities information. It particularly uses the ability of Internet communication to transmit information in a way that responds to user needs, setting out a graduated scheme that caters for the spectrum of investors from retail to sophisticated or professional. The proposal specifically takes account of problems with the existing regulation of electronic delivery and wider developments in the nature of securities disclosure. It also builds on what we know about how well investors use current disclosure documents in investment decision-making, and levels of investor financial literacy.

The consequences for current law are the repeal of regulation which requires the collection by a corporation from investors of express consents to receive securities disclosure electronically. It is the collection of these consents which the report identifies as the major stumbling block to electronic delivery of securities documents. To address problems of notification and access which consents address, the report recommends that the main disclosure documents are greatly shorter than those in current use, and that financial advisors have the responsibility of notifying their clients of the documents, and incorporating them in suitability reviews done for their clients. In the case of self directed investors, the requirement to use the application form in the foundation document also goes a long way to ensure notification. The policy position behind the recommendations is that the investor should see all the documents making up the disclosure regime proposed, before they invest.

Although this proposal deals in some detail with the form and transmission of disclosure documents, it says little about the detail of the content of the documents. That is left to other Task Force researchers who have been asked to consider the modernisation of the content of disclosure. The only exception to this is that the foundation document should have mandated content, and should be set out using a standard format so that comparison between securities is promoted. The document containing issuer- and investment-specific information should have mandated subjects to be covered, and should promote comparison. In both cases the documents should be short.

There is very little empirical research into user information needs in the area of securities transactions. This strongly suggests that if the general direction of this proposal is adopted, some user testing of the foundation and issuer and investment specific documents should be undertaken. These documents should ideally be designed by a professional web document designer with experience in presenting complex

information. Then individual investor interviews and/or focus groups of investors should be convened to receive responses as to their user-friendliness. This should be done with interviewees able to access and work through the actual documents online, before doing the interviews. There should be a mix of investors from across the spectrum from retail to professional. A group of financial advisors might also be interviewed, since they will have to use the documents too. This step should ensure that as far as possible, obstacles to user-friendliness of the proposed scheme of graduated disclosure are ironed out in advance.

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