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# A Cost Benefit Analysis of the Multi-Jurisdictional Disclosure System between Canada and the U.S.

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**A Cost Benefit Analysis of the  
Multi-Jurisdictional Disclosure System**

**Submitted to the Ontario Securities Commission**

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**June 10, 2003**

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## Executive Summary

The Multi-Jurisdictional Disclosure System (“MJDS”) offers significant savings to Canadian issuers that use it (“Canadian MJDS Issuers”). Our cost benefit analysis reveals that the Net Present Value of aggregate cost savings to Canadian MJDS Issuers from (a) using Forms F-9 and F-10 for U.S. public offerings; (b) using MJDS forms for meeting U.S. continuous disclosure obligations; and (c) minimizing lost “windows of opportunities”, ranges from US\$1.6 billion to US\$3 billion over a ten year period, assuming a discount rate of 7%.

We find that the main savings of MJDS remain intact despite the fact that Canadian MJDS Issuers are being required to comply with the requirements of the *Sarbanes-Oxley Act of 2002* (“SOX”).

The OSC’s Initiatives<sup>1</sup> will not impose additional costs on reporting issuers in Ontario that are using MJDS and complying with SOX requirements to the extent that the OSC’s Initiatives conform to those SOX requirements.

The Net Present Value of the external professional fees paid by Canadian issuers with securities listed in the U.S. to comply with SOX requirements is estimated at U.S.\$683 million over a ten-year period, using a discount rate of seven percent. If Canadian issuers listed in the U.S. were exempted from compliance with SOX requirements by the SEC and could instead comply with comparable Canadian requirements that conform to SOX requirements, this amount would drop to approximately U.S.\$410 million, resulting in savings of approximately U.S.\$273 million.

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<sup>1</sup> The OSC Initiatives refer to the new rules that are expected to be released by the OSC in respect of (i) CEO/CFO certifications of internal controls and procedures; (ii) CEO/CFO certification of financial statements; and (iii) the composition, functioning and responsibilities of audit committees, as described in more detail in Part 5 of this report.

## 1. Introduction

We are pleased to submit this report entitled, “A Cost-Benefit Analysis of the Multi-Jurisdictional Disclosure System” to the Ontario Securities Commission (“OSC”).

SOX and the OSC’s Initiatives raise important issues about the net benefit of MJDS going forward. In Part 2 of this report, we analyze the costs and benefits of MJDS. In Part 3, we assess the impact of SOX requirements on Canadian Eligible MJDS Issuers and the implications on cost savings from MJDS. In Part 4, we analyze the impact of OSC’s Initiatives on Canadian MJDS Issuers, under the assumption that such initiatives maintain conformity to SOX. We also assess the impact of the OSC’s Initiatives not conforming to SOX.

During the course of our analysis, we conducted numerous interviews with relevant stakeholders: (a) three Canadian MJDS Issuers; (b) senior securities lawyers at five Canadian law firms and six U.S. law firms that represent Canadian MJDS Issuers; (c) senior partners at an international accounting firm; and (d) one investment bank. We also met with senior staff at the OSC and at the Toronto Stock Exchange (“TSX”). Confidential information that was provided to us by the stakeholders was used to develop the simple cost-benefit analysis that is presented in this report.

## 2. Principles of Securities Regulation

The purpose of securities law is to maintain investor confidence in the marketplace and to enhance the efficiency of capital markets.<sup>2</sup> Given the increasingly global nature of capital markets, securities laws should be designed so as to retain and attract capital to Ontario.<sup>3</sup>

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<sup>2</sup> The *Securities Act (Ontario)* R.S.O. 1990, CHAPTER S.5, s 1.1 states the purposes of the act are: “(a) to provide protection to investors from unfair, improper or fraudulent practices; and (b) to foster fair and efficient capital markets and confidence in capital markets.”

<sup>3</sup> *The Five Year Review Committee Draft Report – Reviewing the Securities Act (Ontario)* recommended that section 2.1 of the *Securities Act (Ontario)* be amended to direct the OSC to have regard to, *inter alia*, the principal that “capital markets are international in character and it is desirable to maintain the competitive position of Ontario's capital markets” in pursuing the objectives of the *Securities Act (Ontario)*.

### **3. Cost Benefit Analysis of MJDS**

#### **(a) Introduction**

The MJDS was adopted in 1991 by the Canadian Securities Administrators ("CSA") and the Securities and Exchange Commission of the United States ("SEC") to reduce duplicative regulation and facilitate cross-border securities offerings by certain eligible Canadian reporting issuers in U.S. capital markets and certain eligible U.S. reporting issuers in Canadian capital markets.<sup>4</sup> The MJDS is a system of mutual recognition that allows Canadian and U.S. issuers to carry on inter-jurisdictional securities activity with greater efficiency and reduced transactions costs.

The MJDS operates on the basis that the underlying principles and policies and the overall practices and substantive standards of securities regulation in Canada and the U.S. are substantially similar.

Under MJDS, eligible Canadian issuers can offer securities to the public in the U.S. using a prospectus prepared in accordance with Canadian standards. The document is filed with and reviewed by the applicable Canadian securities regulator(s). It is also filed with the SEC. A Canadian issuer is eligible to use MJDS Form F-9 to make a public offering in the U.S. of investment grade debt and preferred stock if it has a twelve-month reporting history in Canada; if the securities are convertible after one year, the issuer must also have a public float of U.S.\$75 million. A Canadian issuer is eligible to use MJDS Form F-10 to make public offerings of any security in the U.S. if it has a market capitalization of U.S.\$75 million and a twelve-month reporting history in Canada.

Under MJDS, eligible Canadian issuers can fulfill their continuous disclosure requirements under the U.S. *Securities Exchange Act of 1934* by filing their Canadian continuous disclosure documents with the SEC. Canadian MJDS Issuers may file their Canadian Annual Information Form ("AIF"), Management Discussion and Analysis ("MD&A") and Canadian GAAP financial statements (reconciled to U.S. GAAP) on Form 40-F. The SEC does not generally review Form 40-F. Canadian issuers that are ineligible to use MJDS are required to file continuous disclosure documents as foreign private issuers using Form 20-F or as U.S. domestic issuers using Form 10-K, both of which are reviewable by the SEC.

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<sup>4</sup> See National Policy No. 45 "Multijurisdictional Disclosure System" (1991) 14 O.S.C.B. 2867, National Instrument 71-101, Companion Policy 71-101CP, Rule 71-801, and Form 71-101F1. See also Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Release No. 33-6902, 56 Fed. Reg. 30036, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) paragraph 84, 812, at 81,860 (July 1, 1991); See also Release No. 33-6879 and Release No. 33-7025.

As a result of MJDS, the substantive disclosure required for both public offerings and continuous disclosure by Canadian MJDS Issuers (other than the requirement to provide a reconciliation describing material differences between Canadian GAAP and U.S. GAAP financial statements) are determined by Canadian laws and regulations rather than SEC rules.

Eligible Canadian issuers can also use MJDS for rights offerings (Form F-7) and exchange offerings (Form F-8). Due to the greater frequency with which Form F-9 and Form F-10 are used by Canadian issuers, the analysis in this report focuses on these forms and does not analyze the cost savings associated with Form F-7 and Form F-8. In this regard, the conclusions we reach with respect to MJDS savings are limited to those realized from the use of Form F-9 and Form F-10.

### **(b) Use of MJDS By Canadian Issuers**

This section of the report identifies the main uses and savings of MJDS by the Canadian MJDS Issuers that use Forms F-9 and F-10.

#### **(i) Public Offerings**

From 1991 to 2002, Canadian MJDS Issuers used Form F-9 for 105 public offerings and Form F-10 for 224 public offerings.<sup>5</sup>

MJDS provides significant benefits to eligible Canadian issuers conducting public offerings in the U.S. There was unanimous agreement amongst all stakeholders we interviewed that a Canadian issuer ought to use MJDS for a public offering if it is eligible to do so.

Canadian issuers that are not eligible to use Form F-9 or Form F-10 for public offerings because they do not meet the relevant thresholds of market capitalization and/or reporting history must comply with the requirements applicable to foreign private issuers or U.S. domestic issuers.

The benefits of MJDS use by Canadian MJDS Issuers are set out below.

#### *- Canadian Regulatory Requirements May Allow for Incorporation by Reference*

A Canadian MJDS Eligible Issuer can use a short form prospectus under the Prompt Offering Qualification System (the “POP System”) to complete a public offering of securities in the U.S. A short form prospectus allows many items to be incorporated by reference which can result in significant cost savings. However, in MJDS transactions the disclosure in a Canadian short form prospectus is often substantially enhanced so that the offering document that is prepared, contains disclosure that is similar to that prepared for

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<sup>5</sup> Data obtained from Paul, Weiss, Rifkind, Wharton & Garrison’s annual MJDS update (current to December 31, 2002) available at <http://www.paulweiss.com/db30/cgi-bin/pubs/MJDS%20Tables.pdf> (last viewed May 17, 2003).

U.S. domestic issuers. This is done to address potential liability issues and marketing opportunities in the U.S. The resulting document is known as a “short-form/long-form,” implying short-form for Canadian regulatory purposes, but long-form for U.S. marketing and liability purposes. As a result, the disclosure-related savings that MJDS offers in the context of a U.S. public offering is in many cases not substantial.<sup>6</sup>

#### - Absence of SEC Review

The primary aspect of MJDS savings at the offering stage is the absence of SEC review. In Ontario, a short form issuer can often receive initial comments from a Canadian regulator within three to five days and in many cases obtain a final receipt in less than two weeks. In comparison, the SEC takes 30 days for initial comments and five days for subsequent comments. It is important to note that the SEC does not review all registration statements. The SEC may decide that certain issuers warrant “no review” or only a “limited review” of certain aspects of their offering documents. However, lawyers we interviewed consistently indicated that a full review by the SEC could take a total of six to twelve weeks to obtain final clearance. As a result, the SEC review process can be significantly longer than a corresponding MJDS review process conducted by Canadian securities regulators.

The benefits of being reviewed by the Canadian regulator(s) rather than the SEC under MJDS can be broken down into two components, each of which is discussed below.

#### ***(1) Windows of Opportunity***

The first benefit of being reviewed by Canadian regulator(s) rather than the SEC under MJDS relates to the shorter time frame and certainty with which a public offering can be made. The potentially longer SEC review increases the risk that a change in market conditions may prevent the issuer from taking advantage of the “window of opportunity” to raise capital on favourable terms. The shorter review time achieved by Canadian regulators allows an issuer to better estimate its cost of capital and exposes it to a lower risk of negative changes in issuer specific conditions or general market, economic or political conditions.

For example, if interest rates rise during the period of SEC review, an issuer planning to do a debt offering may find itself faced with a higher cost of capital which may require it to borrow less capital than initially planned or borrow capital at a higher net cost. Alternatively, if an issuer’s share price falls or the market declines dramatically during the period of SEC review, an issuer planning on doing an equity offering may need to issue more shares to raise the same amount of capital, resulting in greater dilution of existing shares.

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<sup>6</sup> Note that some lawyers we interviewed indicated that even for a Canadian newly MJDS Eligible Issuer, the short-form/long-form MJDS prospectus was significantly shorter than a U.S. domestic issuer’s long-form offering document. To the extent that the short-form long-form MJDS prospectus may be significantly shorter in some instances, the analysis in this report understates the savings associated with MJDS.

## ***(2) Savings in Professional Fees***

Being reviewed by Canadian regulator(s) rather than the SEC under MJDS can also result in significant cost savings in respect of professional fees.

### **- Legal Fees**

Canadian issuers that wish to access public capital markets in the U.S. must retain both Canadian and U.S. legal counsel. When a Canadian issuer utilizes MJDS to conduct a U.S. public offering, Canadian legal counsel often prepares the prospectus according to Canadian regulatory requirements. If the issuer is advised to do so by its underwriter for U.S. marketing purposes, U.S. legal counsel adds to the disclosure to make it “look like” a U.S. offering document.

When a Canadian issuer conducts a U.S. public offering as a foreign private issuer or as a U.S. domestic issuer, U.S. legal counsel takes primary responsibility for drafting the U.S. offering document; Canadian legal counsel, often times, plays a secondary role.

For the purpose of analyzing the costs and benefits of MJDS in this study, we have assumed that the costs of Canadian legal counsel fees are constant whether or not a Canadian issuer uses MJDS and therefore are netted out in a cost benefit analysis.<sup>7</sup> As a result, our analysis below focuses on savings to Canadian issuers of U.S. legal counsel fees from using MJDS.

Legal fees differ by issuer type, and in conducting our analysis, we devised three broad scenarios:<sup>8</sup> (a) a U.S. equity initial public offering (“IPO”) by a Canadian issuer that is not MJDS eligible; (b) a U.S. equity IPO by a Canadian issuer that just meets MJDS requirements for filing on Form F-10; and (c) a U.S. public equity offering on Form F-10 by a seasoned Canadian MJDS Eligible Issuer with a reporting history of at least 10 years. We asked U.S. lawyers what their average expected fees would be for each class of issuer. Our results are summarized in Table 1 below.

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<sup>7</sup> Most Canadian lawyers that we interviewed indicated that Canadian legal counsel fees might sometimes be *higher* when a Canadian issuer does not use MJDS to make a public offering in the U.S. We were advised that Canadian legal counsel fees might increase because the process of SEC review often takes longer than a comparable Canadian regulatory review and because Canadian legal counsel is still involved in reviewing the documents and providing opinions. If this is true, then MJDS cost savings in this analysis are understated.

<sup>8</sup> Lawyers we interviewed indicated that U.S. legal counsel fees for Form F-9 offerings are often the same or greater than those for Form F-10 offerings. As a result, the analysis in this report uses U.S. legal counsel fees for Form F-10 filings as the basis for calculating the aggregate cost savings associated with use of both Form F-9 and Form F-10.

**Table 1**  
**U.S. Counsel Legal Fees**

(a) U.S. Equity IPO by a Canadian Issuer that is not MJDS Eligible	(b) U.S. Equity IPO by a Canadian newly-MJDS Eligible Issuer (Form F-10)	(c) U.S. Public Equity Offering by a Seasoned Canadian MJDS Eligible Issuer (Form F-10)
U.S.\$300,000-U.S.\$500,000	U.S.\$200,000-U.S.\$350,000	U.S.\$100,000-U.S.\$250,000

A key reason why a Canadian issuer that is not MJDS eligible would on average incur higher U.S. legal counsel fees than a Canadian MJDS Eligible Issuer is because of the benefits associated with the absence of SEC review. The difference represents U.S. legal counsel fees that would otherwise be incurred in addressing the SEC’s comments in the absence of MJDS.

A comparison of a Canadian issuer’s U.S. counsel legal fees under the first and second scenarios above reveals some information on the savings in U.S. legal counsel fees from not having an SEC review. This is because the issuer’s characteristics are relatively similar under both these scenarios, making it unnecessary to control for them. As Table 1 reveals, our research suggests a range of U.S.\$300,000 to U.S.\$500,000 for the first scenario and a range of U.S.\$200,000 to U.S.\$350,000 for the second scenario. These figures suggest that in the absence of MJDS, when a Canadian issuer would be subject to full review by the SEC, such issuer’s U.S. legal counsel’s fees would be approximately 150% more than under the MJDS.

In order to test the accuracy of this result, we used another method to quantify savings in U.S. legal counsel fees. Since the SEC generally takes thirty days to provide initial comments on an issuer’s offering document, there ought to be only minimal legal fees incurred during that thirty day time period. Deducting this time from the six to twelve week range that is needed on average to complete SEC review leaves us with approximately two to eight weeks during which U.S. legal counsel is addressing comments as compared to the three days to two weeks that Canadian regulators would take under MJDS. Post receipt of initial comments from the SEC, the regulatory approval process is still four times longer in the absence of MJDS.

A reasonable assumption would be that U.S. legal counsel would work as intensively on a per day basis during the two to eight week period as it would during the shorter MJDS time period of three days to two weeks. However, we adopt a more conservative approach of assuming that SEC review results in an eighty percent per day workload relative to a similar process under MJDS. This implies that SEC review results in Canadian issuers incurring roughly three times more in U.S. legal counsel fees as

compared to MJDS (4 times longer process after initial comments are received by the regulators x 80%).

As a result, we conclude that, on average, a Canadian issuer's U.S. legal counsel fees would be one and a half to three times higher if MJDS did not exist or were eliminated.

### **- Accounting Fees**

We have found that MJDS savings in respect of accounting and auditing fees are not substantial. Canadian MJDS Issuers using MJDS Forms F-9 and F-10 do not need to prepare U.S. GAAP financial statements when doing public offerings in the U.S. They can use their Canadian GAAP financial statements but must prepare a reconciliation with U.S. GAAP. Since this benefit is also available to Canadian issuers that are foreign private issuers, it was not taken into account in our cost benefit analysis. We were advised that the cost of auditing financial statements (which includes an audit of the U.S. GAAP reconciliation statement) could be significant. However, this cost also does not factor into our cost benefit analysis because it is a cost incurred by Canadian issuers using MJDS as well as Canadian issuers that are foreign private issuers.

It is important to highlight however that Canadian MJDS Issuers that issue non-convertible preferred stock or investment grade debt on Form F-9 are relieved of the requirement to prepare an audited U.S. GAAP reconciliation. To the extent that this benefit has not been quantified, MJDS savings have been understated in this analysis.

There are at least three accounting differences for a Canadian MJDS Eligible Issuer as compared to a Canadian foreign private issuer that may result in MJDS savings. First, foreign private issuers must report one additional year of Income Statement and Statement of Cash Flow numbers as compared to Canadian MJDS Issuers. However, the cost of this additional reporting is negligible.

Second, MJDS allows a Canadian MJDS Eligible Issuer's Canadian GAAP financial statements (including the reconciliation to U.S. GAAP) to be audited in accordance with Canadian GAAS whereas a foreign private issuer must use U.S. GAAS. U.S. GAAS has different standards than Canadian GAAS. For example, U.S. GAAS requires an engagement letter and a representation letter signed by management while Canadian GAAS does not impose such requirements. Another example is that U.S. and Canadian G.A.A.S. have different standards for fraud. We understand from our interviews that many of the large accounting firms appear to use the U.S. GAAS standards as best practices with which they voluntarily comply. As a result of different standards imposed by U.S. GAAS, there is an incremental cost associated in moving from a Canadian GAAS audit under MJDS to a U.S. GAAS audit as a foreign private issuer.

A final savings for a Canadian issuer conducting a public offering using the MJDS in contrast to a Canadian issuer conducting an offering as a foreign private issuer is that the financial statements for the former are not generally reviewed by the SEC whereas they are generally reviewable for foreign private issuers.

### **- Printer Fees**

The savings in printer fees under MJDS are not significant. As discussed above, a Canadian MJDS Eligible Issuer is entitled to use a Canadian short form prospectus that can be very short because it incorporates many items by reference. However, a Canadian MJDS Eligible Issuer often adds disclosure to its prospectus resulting in a document that is very similar to a U.S. style long-form offering document, as would be the case in the absence of MJDS. Hence, the savings in printer fees savings are not significant.

### **- Underwriting Fees**

Because investment dealers' fees are based on a percentage of the size of an issuer's offering (as opposed to legal and accounting fees that are generally based on hourly rates), there are no significant savings in terms of dealer fees associated with using MJDS.

### **- Regulator Fees**

We ignore differences in fees charged by regulators in our cost benefit analysis. Because the SEC charges Canadian MJDS Issuers the same fees for filing Canadian disclosure documents under MJDS as it would a Canadian issuer filing as a foreign private issuer or U.S. domestic issuer, Canadian MJDS Issuers receive no cost savings in this regard. In effect, SEC fees are charged for filing documents, not for reviewing them. Since the OSC has recently moved to a fee structure that is based more on yearly maintenance as opposed to per-transaction, the analysis does not take into account differences in OSC fees.

### **(ii) Continuous Disclosure**

MJDS is also used by Canadian MJDS Issuers to satisfy their U.S. continuous disclosure obligations. As at December 31, 2002, there were a total of 202 Canadian issuers listed on the New York Stock Exchange, NASDAQ or the American Stock Exchange (see Table 2). Of Canadian issuers that filed annual disclosure documents in 2002, 45% used the MJDS Form 40-F, 33% filed Form 20-Fs as foreign private issuers and 22% filed Form 10-Ks as domestic issuers.<sup>9</sup>

**TABLE 2  
ANNUAL DISCLOSURE FILINGS**

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<sup>9</sup> Data for Table 2 was compiled from Paul, Weiss Rifkind, Wharton & Garrison's annual MJDS update (current to December 31 2002) available at <http://www.paulweiss.com/db30/cgi-bin/pubs/MJDS%20Tables.pdf> (last viewed May 17, 2003).

**BY CANADIAN ISSUERS<sup>10</sup>**  
**As at December 31, 2002**

Stock Exchange	Total Number of Canadian Issuers	MJDS Issuer Form 40-F	Foreign Private Issuer Form 20-F	U.S. Domestic Issuer Form 10-K
New York Stock Exchange	82	55	9	12
NASDAQ	88	27	37	23
American Stock Exchange	32	5	17	8
Total	202	87	63	43

Both legal rules and market pressures influence the method by which Canadian issuers meet their U.S. continuous disclosure obligations. Certain Canadian issuers that filed as foreign private issuers using Form 20-F may not have met the eligibility criteria for MJDS so as to use MJDS Form 40-F. Other Canadian issuers did not meet the definition of foreign private issuer and thus had to meet their continuous disclosure obligations using U.S. domestic issuer Form 10-K.

Interviews with stakeholders indicate that despite being eligible to use MJDS Form 40-F, many eligible Canadian MJDS Issuers “voluntarily file” foreign private issuer Form 20-F or U.S. domestic issuer Form 10-K. This is often because they want to provide information that is comparable to U.S. domestic issuers, and “look like” U.S. domestic issuers. Since competitors may be based in the U.S. and file as U.S. domestic issuers, they want to make it as easy as possible for U.S. research analysts to follow their stock. On the other hand, we were also told that many eligible Canadian MJDS Issuers that consider themselves “North American” or “World Class” issuers have a clear preference to use the MJDS Form 40-F expressly because it is not generally reviewed by the SEC.

The savings in U.S. counsel legal fees associated with using MJDS forms for annual disclosure as opposed to foreign private issuer forms or domestic issuer forms are not substantial. Interviews with U.S. lawyers indicate that U.S. counsel legal fees for filing MJDS Form 40-F are in the range of U.S.\$1,000 to U.S.\$10,000, as compared to U.S.\$7500 to U.S.\$12,000 for filing a Form 20-F as a foreign private issuer or Form 10-K as a U.S. domestic issuer.

The savings in accounting fees that were discussed earlier with respect to offerings are also relevant in the context of continuous disclosure obligations. The most important difference between filing an MJDS Form 40-F as opposed to a foreign private issuer Form 20-F or U.S. domestic issuer Form 10-K is that the first form is not generally reviewable by the SEC while the latter two forms are.

<sup>10</sup> The sum of columns 3, 4 and 5 do not equal column 2 because some Canadian issuers do not appear to have filed in 2002. *Id.*

### (c) Expanded Cost Benefit Analysis

The above discussion lays the foundation for the cost benefit analysis of MJDS. The cost benefit analysis proceeds from fundamental and widely accepted principles of public economics analysis.

In calculating costs and benefits of MJDS, the party that our analysis focuses on is Canadian issuers that use (a) MJDS Form F-9 for U.S. public offerings of preferred stock and investment grade debt; and (b) MJDS Form F-10 for other U.S. public securities offerings.

Canadian issuers receive the same benefits from raising capital in U.S. public markets whether or not they employ MJDS. The relevant savings for Canadian issuers from MJDS stem from cost differences. Or

- $\text{Benefits} = \text{Costs}_{\text{NONMJDS}} - \text{Costs}_{\text{MJDS}}$
- Where  $\text{Costs}_{\text{NONMJDS}} = \text{Total Costs of Issuers in a Non-MJDS Scenario}$
- $\text{Costs}_{\text{MJDS}} = \text{Total Costs of Issuers in a MJDS Scenario}$

We know that:

- $\text{Costs}_{\text{NONMJDS}} = \text{Legal Costs}_{\text{NONMJDS}} + \text{Accounting Costs}_{\text{NONMJDS}} +$

$\text{Underwriter Fees}_{\text{NONMJDS}} + \text{Printing Costs}_{\text{NONMJDS}}$

Similarly:

- $\text{Costs}_{\text{MJDS}} = \text{Legal Costs}_{\text{MJDS}} + \text{Accounting Costs}_{\text{MJDS}} + \text{Underwriter Fees}_{\text{MJDS}}$   
 $+ \text{Printing Costs}_{\text{MJDS}}$

As elaborated above, there is little difference in accounting costs, underwriter fees, and printing costs between MJDS and non-MJDS scenarios. Instead significant cost differences arise from the variation in U.S. legal counsel fees from both the review and disclosure processes. Or using the above notation:

- $\text{Benefits} = \text{Costs}_{\text{NONMJDS}} - \text{Costs}_{\text{MJDS}} = \text{Legal Costs}_{\text{NONMJDS}} - \text{Legal Costs}_{\text{MJDS}}$

*Cost Savings from U.S. Legal Counsel Fees associated with MJDS Forms F-9 and F-10*

We calculate costs savings separately for (a) a newly eligible Canadian MJDS Issuer and a (b) seasoned Canadian MJDS Issuer. Within this classification, cost savings with respect to not having an SEC review are estimated by taking the difference between the upper and lower bounds of the issuer's U.S. counsel's legal fees charged under MJDS detailed above, and the upper and lower bounds generated by our assumption that legal fees under a non-MJDS scenario should be between one and a half to three times higher.

For example, for a type (a) issuer, U.S. legal counsel's fees have been estimated to be between U.S.\$200,000 to U.S.\$350,000 under MJDS. If we assume that fees are one and a half times higher in a non-MJDS scenario, then a Canadian issuer's U.S. legal counsel fees should be between U.S.\$300,000 to U.S.\$525,000. Cost savings under MJDS then range between **U.S.\$100,000** (U.S.\$300,000-U.S.\$200,000) to **U.S.\$175,000** (U.S.\$525,000-U.S.\$350,000).

Using similar methodology, we obtain a cost savings of **U.S.\$400,000** (U.S.\$600,000-U.S.\$200,000) to **U.S.\$700,000** (U.S.\$1,050,000-U.S.\$350,000) for a type (a) issuer assuming a three times cost difference. Hence, cost savings for type (a) issuers under MJDS range from **U.S.\$100,000** to **U.S.\$700,000**, assuming that legal fees under a non-MJDS scenario should be between one and a half to three times higher.

For a type (b) issuer, the issuer's U.S. legal counsel fees have been estimated to be between U.S.\$100,000 to U.S.\$250,000 using MJDS. If fees are one and a half times higher in a non-MJDS scenario, then fees should be U.S.\$150,000 to U.S.\$375,000. Cost savings under MJDS are then between **U.S.\$50,000** (U.S.\$150,000-U.S.\$100,000) to **U.S.\$125,000** (U.S.\$375,000-U.S.\$250,000). Using similar methodology, we obtain a cost savings of between **U.S.\$200,000** (U.S.\$300,000-U.S.\$100,000) to **U.S.\$500,000** (U.S.\$750,000-U.S.\$250,000) for a type (b) issuer assuming a three times cost difference.<sup>11</sup> Consequently, cost savings for type (b) issuers under MJDS range from **U.S.\$50,000** to **U.S.\$500,000**, assuming that legal fees under a non-MJDS scenario are between one and a half to three times higher.

The next step is to calculate these costs and cost savings on an aggregate basis, which requires taking into account the total number of Canadian MJDS Issuers. Canadian MJDS Issuers used Form F-9 for public offerings in the U.S. 12 times on an average annual basis in each of 1999, 2001 and 2002. Similarly, during the same time period, Canadian MJDS Issuers used Form F-10 on average for 20 issuances per year.

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<sup>11</sup> The analysis for type (b) issuers assumes that the SEC will engage in a full review of an issuer's offering documents if it makes a public offering as a foreign private issuer or as a U.S. domestic issuer. However, the SEC does not review all offering documents. It is possible that, in the absence of MJDS, the SEC may decide that certain seasoned issuers warrant "no review" or "limited review" in which case the cost savings of MJDS would be less than noted above. A more complex model would factor in the probability of SEC review.

Assuming that all these issuers were type (a), then savings benefits from MJDS to Canadian MJDS Issuers on an annual basis are between **U.S.\$3,200,000**  $((20 + 12) \times \text{U.S.}\$100,000)$  to **U.S.\$22,400,000**  $((20 + 12) \times \text{U.S.}\$700,000)$ . However, if we assume that all of these issuers were type (b), then savings from MJDS to Canadian MJDS Issuers annually are between **U.S.\$1,600,000**  $((20 + 12) \times \text{U.S.}\$50,000)$  and **U.S.\$16,000,000**  $((20 + 12) \times \text{U.S.}\$500,000)$ .

Hence, in aggregate, MJDS has resulted in cost savings of between **U.S.\$1,600,000** to **U.S.\$22,400,000** to Canadian MJDS Issuers on an annual basis for public offerings on Forms F-9 and F-10.

#### *Cost Savings in U.S. Counsel Legal Fees associated with MJDS Form 40-F*

With respect to continuous disclosure savings for MJDS Form 40-F, our research indicates, as noted above, that for both issuer types (a) and (b), U.S. legal counsel fees under MJDS can run between U.S.\$1,000 to U.S.\$10,000, while in a non-MJDS scenario, corresponding costs are between U.S.\$7,500 to U.S.\$12,000. Therefore, cost differences are between **U.S.\$2,000**  $(\text{U.S.}\$12,000 - \text{U.S.}\$10,000)$  to **U.S.\$6,500**  $(\text{U.S.}\$7,500 - \text{U.S.}\$1,000)$ .

With respect to continuous disclosure, available data reveals that on average, 87 Canadian MJDS Issuers used MJDS Form 40-F in 2002 to satisfy their U.S. annual disclosure obligations. Therefore, costs savings for annual disclosure filings for Canadian MJDS Issuers are between **U.S.\$174,000**  $(87 \times \text{U.S.}\$2,000)$  to **U.S.\$565,500**  $(87 \times \text{U.S.}\$6,500)$  on an annual basis.

#### *Cost Savings in respect of Windows of Opportunity*

As discussed above, Canadian regulatory review ranges on average from three days to two weeks while a corresponding SEC process can take, on average, between six to twelve weeks. Hence, on average, Canadian MJDS Issuers can shorten the regulatory review process significantly (five and a half to ten weeks), and thus minimize possible losses from missed windows of opportunity for favourable financing.

One method to quantify MJDS cost savings from a shorter regulatory review process is by assuming that the longer the review process takes, the greater the issuer's opportunity cost as represented by a proportionate decline in share prices.

Hence, we examined monthly trends in the TSE/S&P index for 2001 and 2002. Available data suggests that the index declined by an average of 1.7% per month during this time period. If MJDS saves Canadian issuers between five and a half to ten weeks then it also prevents, on average, between a 2.3375%  $(1.375 \text{ months} \times 1.7\%)$  to a 4.25%  $(2.5 \text{ months} \times 1.7\%)$  decline in average share prices.

Available data indicates that Canadian MJDS Issuers made 16 equity public offerings in the U.S., on average, in each of 2001 and 2002, for an average value of approximately U.S.\$569 million.

Assuming a constant number of shares, a Canadian MJDS Issuer that employed MJDS to make an equity public offering in the U.S. in 2001 and 2002 managed to avoid between a **U.S.\$13,300,375** ( $2.3375/100 \times \text{U.S.}\$569 \text{ million}$ ) and **U.S.\$24,182,500** ( $4.25/100 \times \text{U.S.}\$569 \text{ million}$ ) loss in share value due to potentially longer review by the SEC.<sup>12</sup>

On average, since there were 16 Canadian issuers that used MJDS to issue equity in each of 2001 and 2002, aggregate MJDS savings for these Canadian issuers was **U.S.\$212,806,000** ( $\text{US } \$ 13,300,375 \times 16$ ) to **U.S.\$386,920,000** ( $\text{US } \$24,182,500 \times 16$ ), on an annual basis.

It should be noted that this analysis focuses on lost windows of opportunity during market declines and does not assess the impact to issuers of market upswings while waiting for regulatory approval. This is important as the above benefits may then be netted out.

In Parts 4 and 5 of this report, we consider the impact of SOX and the OSC's Initiatives on the MJDS cost savings we have arrived at in this part of the report.

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<sup>12</sup> As noted in other parts of this report, if the SEC chose to conduct "No Review" of a certain issuer's offering documents, there would be no cost savings.

#### **4. The Impact of SOX on Canadian MJDS Issuers**

The enactment of SOX in 2002 brought sweeping changes to U.S. securities laws. This part first discusses SOX requirements as they apply to Canadian MJDS Issuers. We then analyze the practical implications of these new requirements for Canadian MJDS Issuers, and assess the implications of SOX on the cost benefit analysis of MJDS conducted in Part 3 of this study. We conclude by analyzing the policy implications of SOX for the continued existence of MJDS.

##### **(a) SOX requirements as applied to Canadian MJDS Issuers**

Notwithstanding the general principle that MJDS documents are governed by Canadian laws and regulations and are reviewed by Canadian securities regulators, SOX contains mandatory features that changes how Canadian MJDS Issuers prepare their disclosure documents and potentially subjects Canadian MJDS Issuers to review by the SEC.

The effect of SOX requirements on Canadian MJDS Issuers will depend on how the mandatory rules in SOX are interpreted and the substance of the rules that the SEC is required to create with respect to SOX.

It is significant to note that SOX does *not* contain any general exemption for Canadian MJDS Issuers or other foreign private issuers. As a general matter, the SEC has the authority to create exemptions for Canadian MJDS Issuers and foreign private issuers.

It is uncertain whether the SEC will create exemptions for foreign private issuers including Canadian MJDS Issuers from SOX requirements. However, the SEC's *Final Rule on Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations* released on January 27, 2003, clearly states that it applies to foreign private issuers and Canadian MJDS Issuers:<sup>13</sup>

##### **Application to Foreign Private Issuers**

The amendments apply to foreign private issuers that file annual reports on Form 20-F or on Form 40-F. Because Section 401(a) of the Sarbanes-Oxley Act does not distinguish between foreign private issuers and U.S. companies, we interpret Congress' directive to the Commission to adopt rules requiring expanded disclosure about off-balance sheet transactions in annual reports filed with the Commission to apply equally to Form 20-F or 40-F annual reports filed by foreign private issuers and to Form 10-K or 10-KSB annual reports filed by domestic issuers. ... *We do not believe that it is appropriate to exempt foreign private issuers or MJDS filers because, as discussed below, the disclosure requirements do not represent*

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<sup>13</sup>Release No. 33-8182 (Jan. 28, 2003) [68 FR 5982] (Effective: April 7, 2003)

*a fundamental change in our approach with respect to the financial disclosure provided by foreign private issuers and MJDS filers.*

There are two additional reasons for applying the amendments to foreign private issuers' annual reports filed with the Commission. First, investors and others would enjoy the same benefits from expanded off-balance sheet disclosure in foreign private issuers' annual reports as they would from this disclosure in domestic issuers' annual reports. Second, for Form 20-F annual reports, the existing MD&A-equivalent requirements for foreign private issuers currently mirror the substantive MD&A requirements for U.S. companies. We believe this desirable policy should continue.

The disclosure provided by Canadian issuers that file Form 40-F is generally that required under Canadian law. We have, however, supplemented these disclosure requirements with specific required items of information. We have adopted additional disclosure requirements under Form 40-F as a result of the Sarbanes-Oxley Act. *Although an issuer prepares its MD&A discussion contained in a Form 40-F registration statement or annual report in accordance with Canadian disclosure standards, we believe that requiring disclosure of off-balance sheet arrangements and a table of contractual obligations in accordance with SEC rules is not inconsistent with the principles of the MJDS, is consistent with the Sarbanes-Oxley Act and, most importantly, will provide investors with useful information that is comparable to that provided by U.S. and other foreign companies that file reports under the Exchange Act. (Emphasis added.)*

Nonetheless, it is possible that the SEC may grant exemptions for Canadian MJDS Issuers and other foreign private issuers in respect of other provisions of SOX. We have identified several provisions of SOX that are particularly relevant to Canadian MJDS Issuers:

- i. A mandate for the SEC to review filings every three years;
- ii. Addition of substantive disclosure requirements to MJDS continuous disclosure forms; and
- iii. Corporate governance measures including CEO/CFO certifications and institution of disclosure controls and procedures and other changes in internal business practices.

The cost implications of these provisions on Canadian MJDS Issuers are discussed in the following section.

### **(b) Impact of SOX on MJDS Cost Savings**

SOX requirements are focused on continuous disclosure and they increase the cost of compliance with continuous disclosure requirements. Generally speaking, to the extent that Canadian MJDS Issuers, foreign private issuers and U.S. domestic issuers are all required to comply with SOX, the cost benefit analysis in Part 3 does not change since the overall cost of continuous disclosure compliance has increased for all of them. This conclusion is elaborated on below.

#### **(i) Public Offerings**

Generally speaking, SOX does not have a large impact on the cost of public offering transactions in the U.S., be it for a Canadian MJDS Eligible Issuer, foreign private issuer, or a U.S. domestic issuer.<sup>14</sup> The absence of SEC review of listing and offering documents under MJDS remains post-SOX and so this savings remains intact for Canadian MJDS Issuers post-SOX.

#### **(ii) SEC's Review of Filings**

Section 408 of SOX requires the SEC to review filings of issuers at least once every three years. The benefits associated with the absence of SEC review of MJDS continuous disclosure reports would change if the SEC decides to apply section 408 to Canadian MJDS Issuers. If the SEC does *not* apply this provision to Canadian MJDS Issuers, the savings associated with the absence of SEC review to such issuers could potentially increase because the SEC is putting additional resources into continuous disclosure review of other issuers.

To date, the SEC has not provided specific guidance on how it plans to interpret section 408 and whether it will review MJDS continuous disclosure forms filed by Canadian MJDS Issuers.

In a letter to the SEC dated February 19, 2003, the CSA suggested that the SEC and Canadian regulators explore the possibility of mutual reliance of reviews by regulators in the other jurisdiction or joint reviews. The letter reads:

#### Continuous Disclosure Review

The CSA has established and continues to develop an increasingly robust process for continuous disclosure review. For example, some jurisdictions have a goal that issuers based in their jurisdiction are subject to a continuous disclosure review once

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<sup>14</sup>One source of additional expense for public offerings by Canadian MJDS Issuers, foreign private issuers and U.S. domestic issuers is with respect to disclosure of off-balance sheet transactions.

every four years on average. To date, this goal has been met or exceeded. Issuers that meet certain risk-based selection criteria are reviewed much more often than once every four years; indeed, some issuers are currently subject to “real time reviews”, under which those issuers’ disclosures are monitored at the time they are filed. Other jurisdictions do not have a fixed cycle of reviews but do all reviews using a risk-based methodology. We believe that the CSA’s continuous disclosure initiatives compare favourably to the requirement contained in SOX that U.S. issuers be reviewed no less frequently than once every three years.

Canadian Issuers that are U.S. registrants are subject to continuous disclosure review by both Canadian and U.S. regulators. These reviews can entail considerable duplication of effort. This duplication will increase substantially as the review programs in both our jurisdictions become more robust and comprehensive.

*We would like to explore with the SEC the possibility of a protocol that would enable Canadian securities regulators and the SEC to rely on reviews conducted by the other, subject to appropriate systems of oversight. Alternatively, we could explore the possibility of a joint continuous disclosure review process of those issuers that are inter-listed. The Ontario Securities Commission and the SEC have, in the past, carried out joint reviews of Canadian issuers that are U.S. registrants. The CSA would be happy to discuss procedures for information sharing, joint reviewing, consulting, and any other matters relevant to this objective. (Emphasis added.)*

We understand that, to date, the SEC has not clarified its position in this regard.

### **(iii) Corporate Governance Measures**

With respect to corporate governance, SOX also imposes new business imperatives such as CEO/CFO certification and disclosure controls and procedures and other changes in internal business practices. However, these provisions are applicable equally to Canadian MJDS Issuers, foreign private issuers, and U.S. domestic issuers.<sup>15</sup> Because these costs are imposed on all three classes of issuers, the cost savings associated with MJDS analyzed in Part 3 are not affected.

### **(c) Costs of Compliance with SOX**

SOX increases the costs of compliance for Canadian MJDS Issuers as well as Canadian issuers that report as foreign private issuers and U.S. domestic issuers. The incremental costs of compliance relate primarily to increases in: (a) external audit fees; (b) U.S. legal

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<sup>15</sup> However, note that CEO/CFO certification is not required for financial statements on MJDS Form 6-K.

counsel fees; (c) directors' and officers' insurance premiums; and (d) increases in time spent by directors, officers and staff in complying with SOX.

A survey conducted by U.S. law firm Foley & Lardner found that SOX has doubled the cost of being a public company in the U.S. from U.S.\$1.3 million to almost U.S.\$2.5 million.<sup>16</sup> Compliance with SOX is estimated at approximately U.S.\$1.2 million, on average, for a mid-sized public company. Their study was based on responses from 32 mostly mid-sized companies and a review of 328 proxy statements, as well as interviews with accountants, insurers and public relations companies.

The study found that as a result of SOX, directors' and officers' insurance increased 94.2 percent from U.S.\$329,000 to U.S.\$639,000; accounting fees increased by 105 percent from U.S.\$243,000 to U.S.\$499,000; legal fees increased by 90.6 percent from U.S.\$210,000 to U.S.\$404,000; directors' expected annual number of hours devoted to board work almost doubled from an average of 125 to more than 200; and compliance personnel costs increased by 268 percent.

We contacted several Canadian MJDS Issuers in order to estimate their costs of compliance associated with SOX. However, very few issuers responded, and of those that did, few were able to provide us with precise figures.

Our interviews with three Canadian MJDS Issuers suggest that they were of the view that the internal costs of compliance with SOX are significant but that it is too early to precisely indicate what those costs are. For example, many seasoned Canadian MJDS Issuers have regulatory compliance departments that are responsible for matters such as SOX. To the extent that employees in such departments have shifted their focus to address SOX compliance or have added to their workload, many issuers found it difficult to precisely measure the incremental costs associated with SOX compliance.

One issuer, a financial institution interlisted on the TSX and the NYSE, indicated that it had incurred very little in the way of incremental costs. This issuer emphasized that much of the compliance with SOX was accomplished through existing salaried personnel, including Canadian and U.S. lawyers and accounting staff, and it was unable to provide us with an estimate of hours spent by internal personnel. It indicated that they did not incur significant increases in external U.S. legal counsel fees to date because they had a U.S. lawyer on staff.

Another issuer, a large mining and metal company, interlisted on the TSX and the NYSE also advised us that its costs of compliance with SOX has not been overwhelmingly large. This issuer's chief legal counsel indicated that it had incurred US\$50,000 to US\$100,000 to date, comprised of increases in external auditor and U.S. legal counsel fees and also to set up a whistleblower mechanism handled by an independent third party provider.

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<sup>16</sup> Presentation by Lance Jon Kimmel & Steven Vanquez of Foley Lardner entitled "The Increased Financial and Non-Financial Cost of Staying Public" at the National Directors Institute (Chicago: April, 2003)

However, another issuer, a large financial institution, interlisted on the TSX and the NYSE, with an international presence and U.S. subsidiaries, suggested that it was incurring significant costs in complying with SOX. This issuer's chief accountant estimated its sunk or one-time costs to be over CDN\$5 million. It was estimated that the external auditor would spend 1,000 additional hours at a value of CDN\$1 million, and that internal accounting staff would spend 2,000 hours at a value of CDN\$2 million. It was estimated that compliance measures for each of the issuer's divisions would total over CDN\$2 million. Annual increases in the external auditor's fees were estimated at CDN\$500,000.

Given the rather wide range of values we obtained from our interview process, we extrapolated average values of compliance with SOX from the Foley Lardner study. As the study indicates, a mid-sized U.S. issuer experienced an increase of U.S.\$256,000 in accounting fees (from U.S.\$243,000 to U.S.\$499,000) and an increase of U.S.\$194,000 in legal fees (from U.S.\$210,000 to U.S.\$404,000), resulting in a total cost increase in external professional fees in the amount of U.S.\$450,000. We assume that these figures also apply to Canadian issuers listed in the U.S.<sup>17</sup> For the purpose of our analysis, we focus on external accounting and legal fees, as these were the costs that were consistently referred to by issuers we interviewed. As indicated earlier, Table 2 reveals that there are a total of 202 Canadian issuers listed on the NYSE, NASDAQ and the American Stock Exchange. Based on these assumptions, compliance with SOX has increased the fees paid to external legal and accounting professionals by an aggregate of U.S.\$90,900,000 (202 x U.S.\$450,000) for these Canadian issuers.

Would these Canadian issuers experience significant costs savings if the SEC exempted them from compliance with requirements under SOX and allowed them to comply with comparable Canadian requirements that conform to SOX?

One Canadian issuer indicated that its costs of compliance would have been fifty percent less if it instead could have complied with Canadian rules that conform to SOX. If Canadian MJDS Issuers (and other Canadian issuers currently required to comply with SOX) were exempted by the SEC from SOX compliance and could instead comply with Canadian regulatory standards that conform to SOX, it is possible that such issuers would experience some level of cost savings. This would result from Canadian issuers being able to hire external Canadian professional advisors as opposed to external U.S. professional advisors whose billings would be approximately one-third less when the exchange rate is taken into account. To the extent that comparable Canadian advisors charge marginally less than their U.S. counterparts, there very well could be other savings in addition to the thirty-three percent savings resulting from the exchange rate. While we cannot with confidence conclude that there would be an overall fifty percent savings, there is certainly a possibility that Canadian issuers' costs of compliance would be reduced significantly.

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<sup>17</sup> 80% of the Foley Lardner's survey responses were from companies with revenues under U.S.\$1 billion and 20% were from companies with revenues over U.S.\$1 billion. The survey notes that "the costs for larger mid-cap and S&P 500 companies will be proportionately more (3-5x) higher in dollar terms".

This reasoning suggests that the figure of U.S.\$90 million that we have indicated is the aggregate cost of external professional fees paid by Canadian issuers currently required to comply with SOX requirements could drop by at least thirty-three percent and likely to more than forty percent if such issuers were instead able to comply with comparable Canadian requirements that conform to SOX requirements. Using forty percent as the estimated cost savings, we conclude that if Canadian issuers listed in the U.S. could comply with Canadian requirements that conform to SOX requirements instead of compliance with SOX requirements, their compliance costs would drop to U.S.\$54,540,000.

There is a risk at the margin that given the new SOX requirements, some Canadian issuers, MJDS eligible or otherwise, may exit (or not access) U.S. public capital markets, because in absolute terms, it has become too expensive. However, this is unlikely for seasoned Canadian MJDS Issuers. Many of the increased cost of compliance with SOX are one-time implementation costs and their significance should be considered on an on-going basis. Internal compliance costs, external auditing fees and external U.S. counsel legal fees to put internal business practices in place and get up the learning curve on new corporate governance methods could be substantial up front, but when amortized over the long run, they are not significant, especially for seasoned Canadian MJDS Issuers.

The next part of this report addresses the OSC's Initiatives and the implications for MJDS.

## 5. The OSC's Initiatives

Following the SEC's lead with SOX, a number of significant amendments were made to the *Securities Act (Ontario)*.<sup>18</sup> These amendments were proclaimed into force effective April 7, 2003. The OSC now has the authority to require reporting issuers to appoint audit committees and prescribe requirements on the functioning and responsibilities of audit committees. The amended *Securities Act (Ontario)* also authorizes the OSC to create rules with respect to CEO and CFO certification similar to those currently in effect in the U.S. pursuant to SOX including certification of systems of internal control and disclosure controls. The OSC has also been granted rule-making authority to prescribe financial accounting, and reporting and auditing requirements. The OSC is in the process of preparing draft rules to be released for comment with respect to this rule-making authority.

This part of the report analyses the OSC's Initiatives, their relationship to SOX and their impact on MJDS. This part of the report also analyses the policy implications and practical impact on Canadian MJDS Issuers, if provinces other than Ontario do not also conform to SOX. Finally, this section analyses the implications for the cost benefit analysis conducted in Parts 3 and 4 of this study.

### (a) Effect of the OSC's Initiatives on MJDS Savings

The OSC's Initiatives will *not* significantly impact the cost of offerings to reporting issuers in Ontario (whether Canadian MJDS Issuers or not) because neither SOX requirements nor the OSC's Initiatives focus on the offering stage. The cost savings of MJDS associated with the absence of SEC review for offerings remain intact, irrespective of whether the OSC's Initiatives are implemented and whether or not they conform to SOX.

The cost savings of MDJS associated with the absence of SEC review of MJDS Form 40-F (subject to application of section 408 of SOX requiring SEC review at least every three years) also remain intact, even if the OSC's Initiatives are implemented and do not conform exactly to SOX.

The OSC's Initiatives with respect to corporate governance measures *will* impose additional costs on all reporting issuers in Ontario that do *not* report in the U.S. However, the OSC's Initiatives will *not* impact reporting issuers in Ontario that are Canadian MJDS Issuers, foreign private issuers or U.S domestic issuers, and are therefore already subject to SOX so long as the OSC's Initiatives conform exactly to SOX.

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<sup>18</sup> See amendments to the *Securities Act (Ontario)* in S.O. 2002, c.22, *Keeping the Promise for a Strong Economy Act (Budget Measures)*, 2002.

Canadian MJDS Issuers that were interviewed for this study emphasized that the OSC should conform its rules entirely to SOX. They suggested that any slight differences from the SOX requirements with which they are required to comply would impose additional costs on them. Several of such issuers indicated that if the OSC plans to even slightly change its requirements from those in SOX, that reporting issuers in Ontario that are eligible to use MJDS (or that must comply with SOX) be exempted from the OSC's Initiatives or, in the alternative, be permitted to file their SOX disclosures with the OSC.

### **(b) Impact on MJDS of Canadian Rules Conforming to SOX**

As noted above, the short-term status of MJDS is that all pre-SOX Canadian MJDS Issuers are entitled, post-SOX, to use MJDS for offerings and continuous disclosure so long as they comply with SOX. This is irrespective of whether the OSC and/or the other provincial securities commissions implement rules that conform to SOX. In the long run, however, the greater the actual or perceived gap between Canadian and U.S. regulatory standards, the greater the risk that MJDS could be eliminated. To this end, adoption of rules nationally that conform to SOX will increase the probability of maintaining MJDS and also obtaining a carve-out for Canadian issuers from SOX requirements.

Provinces that do not conform to SOX may experience capital flight, at the margin. Empirical studies indicate that over time high quality issuers migrate to jurisdictions with stronger investor protection regimes. These studies reveal that issuers that make credible commitments to the market to observe higher standards of disclosure and corporate governance experience lower costs of capital,<sup>19</sup> greater liquidity,<sup>20</sup> higher returns<sup>21</sup> and enhanced analyst coverage.<sup>22</sup> Non-SOX conforming provinces could attempt to avoid net

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<sup>19</sup> See D.W. Diamond and R.E. Verrechia, "Disclosure, Liquidity and the Cost of Capital", 46 J. Finance (1991) 1325 (Finding a commitment to increased disclosure, which reduces information asymmetries, produces lower costs of capital); C.B. Barry and S.J. Brown, "Limited Information as a Source of Risk", 12 J. Portfolio Management 66. (Investors usually have less than perfect information on firm profitability, and if this risk is non-diversifiable, investors will demand an incremental return for bearing information risk. As a result, firms with high levels of disclosure and consequently low information risk are likely to have a lower cost of capital than firms with low disclosure levels and high information risk.)

<sup>20</sup> O. Kim, & R. Verrechia, "Market Liquidity and Volume Around Earnings Announcements", 17 Journal of Accounting and Economics (1994) 41 (Finding that increased disclosure enhances stock liquidity); See also S. Huddart, John Hughes and Markus Brunnermeier, "Disclosure Requirements and Stock Exchange Listing Choice in an International Context", (Working Paper, 1998)(Finding that exchanges competing for trading volume engage in a "race for the top" under which disclosure requirements increase and trading costs fall.)

<sup>21</sup> See P. Healy, H. Hutton, K. Palepu, "Stock Performance and Intermediation Changes Surrounding Sustained Increases in Disclosure", 16 Contemporary Accounting Research (1999) 485 (Finding that issuers that produce greater disclosure experience significant contemporaneous increases in stock prices that are unrelated to current earnings performance); See Stephen Foerster and G. Andrew Karolyi, "The Effects of Market Segmentation and Investor Recognition on Asset Prices: Evidence from Foreign Stocks Listing in the United States", 54 J. Fin. 981 (Finding that firms cross-listing in the U.S. earn cumulative abnormal returns of 19% in the year before listing).

<sup>22</sup> C.A. Botosan, "Disclosure Level and The Cost of Equity Capital", 72(3) Accounting Review (1997) 323

capital flight (and possibly attract more capital) in the post SOX environment by positioning themselves as niche players providing a more flexible, lenient market for smaller, younger firms that are not ready to access the more mature Canadian and U.S. markets. However, the benefits of a flexible and more lenient regulatory environment could be offset by an increase in issuers' cost of capital and reduced liquidity because of the actual or perceived risks associated with such a marketplace.

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(Finding that firms with low analyst coverage have a negative relation between the cost of equity capital and the extent of their voluntary disclosures). C.A. Botosan and M.A. Plumlee, "A Re-Examination of Disclosure Level and Expected Cost of Capital" (Working Paper, 2000) (Finding a negative cross-sectional relation between cost of capital and analyst rankings of annual report disclosures).

## 6. Summary of Cost Benefit Analysis

The tables below summarize our results and also provide corresponding Net Present Values assuming 4%, 7%, and 10% discount rates over a 10-year period, which is typical for a cost benefit analysis.

**Table 3**  
**Cost Savings From MJDS**  
**(US \$(Over a Ten-Year Period))**

	Annual Figures		4% Discount Rate		7% Discount Rate		10% Discount Rate	
	Lower Bound	Upper Bound	Lower Bound	Upper Bound	Lower Bound	Upper Bound	Lower Bound	Upper Bound
(A) Aggregate Cost Savings to Canadian MJDS Issuers from using Forms F-9 and F-10 for U.S. public offerings	1,600,000	22,400,000	13,496,531	188,951,428	12,024,372	168,341,202	10,814,438	151,402,133.5
(B) Aggregate Cost Savings to Canadian MJDS Issuers from using MJDS annual disclosure forms	174,000	565,000	1,467,748	4,770,180	1,307,650,411	4,249,864	1,176,070	3,822,228
(C) Aggregate Cost Savings to Canadian MJDS Issuers from minimization of lost windows of opportunity	212,860,000	386,920,000	1,795,544,687	3,263,798,507	1,599,692,336	2,907,793,662	1,438,725,810	2,615,201,495
<b>TOTAL</b>	<b>214,634,000</b>	<b>409,885,500</b>	<b>1,810,508,965</b>	<b>3,457,520,115</b>	<b>1,613,024,358</b>	<b>3,080,384,728</b>	<b>1,450,716,318</b>	<b>2,770,425,856</b>

**TABLE 4**  
**Expected Costs of External Professional Fees for Compliance with SOX**

**and Canadian Rules that Conform to SOX  
(US \$) (Over a Ten-Year Period)**

	Annual Figures	4% Discount Rate	7% Discount Rate	10% Discount Rate
(A) Aggregate Costs of External Professional Fees paid by Canadian Issuers listed in the U.S. to comply with SOX	90,900,000	766,771,643	683,134,611	614,395,265
(B) Aggregate Costs of External Professional Fees that would be paid by Canadian Issuers listed in the U.S. assuming the existence of Canadian rules that conform to SOX and an exemption from the SEC from compliance with SOX	54,540,000	460,062,986	409,880,767	368,637,159

## **7. Conclusion**

This report has found that MJDS offers significant savings to Canadian MJDS Issuers. Our cost benefit results are sensitive to discount and upper and lower bound assumptions. Our calculations reveal that the Net Present Value of aggregate cost savings to Canadian MJDS Issuers for (a) using Forms F-9 and F-10 for U.S. public offerings; (b) using MJDS forms for meeting U.S. annual disclosure obligations; and (c) from minimizing lost “windows of opportunities”, ranges from US\$1.6 billion to US\$3 billion over a ten year period, assuming a discount rate of 7%.

We find that the main savings of MJDS remain intact despite Canadian MJDS Issuers being required to comply with SOX.

Our analysis reveals that the OSC’s Initiatives will impose additional costs on all reporting issuers in Ontario that are not Canadian MJDS Issuers. However, the OSC’s Initiatives will not impose additional costs on reporting issuers in Ontario that are Canadian MJDS Issuers to the extent that the OSC’s Initiatives conform with SOX.

The Net Present Value of the external professional fees paid by Canadian issuers listed in the U.S. to comply with SOX is estimated at U.S.\$683 million over a ten-year period, using a discount rate of seven percent. If Canadian Issuers listed in the U.S. were exempted from compliance with SOX by the SEC and could instead comply with Canadian rules that conform to SOX, this amount would drop to approximately U.S.\$410 million, resulting in a cost savings of approximately U.S.\$273 million.

## **Biographies of Authors**

### **Poonam Puri**

Poonam Puri is an Associate Professor of Law at Osgoode Hall Law School, York University. She is a graduate of the University of Toronto Faculty of Law (LL.B. Silver Medalist) and Harvard Law School (LL.M.). She articulated at Torys and was a summer associate at Paul, Weiss, Rifkind Wharton and Garrison in New York. Professor Puri's research focuses on corporate governance, corporate law, securities law, corporate and white-collar crime, bankruptcy law, and law and economics. Professor Puri teaches Corporate Governance, Advanced Securities Regulation, Business Associations, and Markets and Institutions at Osgoode Hall Law School.

Professor Puri has analyzed the reforms arising in the U.S. from the *Sarbanes-Oxley Act of 2002* and the made-in-Canada response to corporate governance reform. She was co-chair (with Bill Braithwaite, Carol Hansell and Jim Turner) of an Osgoode Hall Law School P.D.P. conference entitled Corporate Governance: Crisis and Reform held in the fall of 2002, which explored these issues in detail. Professor Puri is co-author (with Doug Harris, Ed Iacobucci, Ian Lee, Jeffrey MacIntosh, and Jacob Ziegel) of "Cases and Materials on Partnerships and Canadian Business Corporations" (Toronto: Carswell, forthcoming 2003). She is also co-editor (with Jeffrey Larsen) of "Corporate Governance and Securities Regulation in a Post-Enron Era" (Toronto: Butterworths, forthcoming 2003). Professor Puri is currently working on a research report entitled "Local and Regional Interests, Issues and Markets" through the Capital Markets Institute for the recently appointed Wise Persons Committee.

### **Anindya Sen**

Anindya Sen is an Assistant Professor of Economics at the University of Waterloo. After completing his Ph.D. from the University of Toronto, he joined the Canadian Competition Bureau as a staff economist. During that time he supervised and conducted several econometric based analyses intended to assess the competitive effects of proposed mergers and other potential anti-competitive actions by firms. Examples of these cases include the proposed mergers between four of Canada's five largest banks and alleged collusion and price fixing by petroleum companies. He also acted as an expert witness on behalf of the government, testifying at parliamentary committee hearings. After this, he accepted a position as an Assistant Professor at the Department of Economics, University of Waterloo where he continued his research in empirical industrial organization, public finance and more recently, health economics. He has published his work in journals such as the *Journal of Law and Economics*, *Canadian Journal of Economics*, and the *Review of Industrial Organization*. Professor Sen ensured that the cost benefit analysis conducted in this study adhered to established principles of public finance economics.

