

Well-Known Seasoned Issuers in Canada¹

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¹ This paper builds on the 2005 paper “Well-Known Seasoned Issuer in Canada” by Professor Adam C. Pritchard, written in 2006.

INTRODUCTION

Well-Known Seasoned Issuer (WKSI) is a concept adopted by the United States Securities and Exchange Commission (SEC) in 2005. WKSI is a category of issuers that comprises of the largest public companies. The benefit of qualifying as a WKSI is a series of relaxed restrictions on public offerings and the reduction in regulatory burden.

In Canada, market participants have also indicated an interest in adopting a WKSI category. The Capital Markets Modernization Taskforce (“Taskforce”) was formed by the Ontario government in February 2020 with a mandate to review and modernize Ontario’s capital markets. The Report, which followed consultations with market participants, contained 47 proposals. The 12th proposal recommended the creation of a WKSI category.²

While largely replicating the U.S. approach, the Taskforce indicated that the Ontario WKSI category will be tailored to the Canadian market reality where issuers tend to be smaller. The standard adopted in the U.S. is two-fold: the candidate company must either have over \$700 million in market capitalization or have issued over \$1 billion in non-convertible debt over the previous three years.

This paper argues that the \$700 million market capitalization threshold and the \$1 billion debt issuance threshold should be maintained for the Canadian market, even though market participants tend to be smaller on average.

(All monetary amounts are expressed in U.S. dollars.)

AMERICAN RULES

In 2005, the U.S. SEC created WKSIs as a new category of issuers. This category is designed for the most active and widely followed issuers that represent the most significant amount of capital raised and traded in the U.S.

As the SEC observed in 2004, WKSIs represented approximately 30% of listed issuers, accounted for about 95% of U.S. equity market capitalization, and accounted for more than 96% of the total debt raised in registered offerings over the previous eight years by issuers listed on a major exchange or equity market.³ In 2020, the significance of WKSIs has expanded. They represent approximately 32% of all listed issuers and collectively account for 98% of U.S. equity market capitalization (see Table 1).

² Capital Markets Modernization Taskforce, *Consultation Report*, July 2020 [*Consultation Report*].

³ U.S., Securities and Exchange Commission, *Securities Offering Reform*, Securities Act Release No. 33-8591 (July 19, 2005) at 25 [*Securities Offering Reform*].

To qualify as WKSI, the issuer has to meet numerous eligibility requirements. First, the issuer must have filed reports with the SEC for at least a year and have been current on those filings. Second, the issuer must meet one of the following two criteria:

- 1) has outstanding a minimum of \$700 million in worldwide market value of voting and non-voting common equity held by non-affiliates; or
- 2) has issued over the past three years \$1 billion aggregate in non-convertible securities, other than common equity, in primary offerings for cash, not exchange, registered under the Securities Act.

Third, the issuer must not be an ineligible issuer. Ineligible issuers include issuers of asset-backed securities, registered investment companies, and business development companies as defined in the Investment Company Act of 1940, as amended.⁴ Registered investment companies include but are not limited to mutual funds, exchange-traded funds, real estate investment trusts (REITs).⁵

One of the most notable benefits of WKSI status is the exemption from the 30-day quiet period prior to filing a registration statement, also known as the “gun-jumping” restrictions. WKSIs are permitted to engage at any time in oral and written communications.⁶ Thus, WKSIs have much less reason for concern that their public statements, such as press releases and media appearances by corporate officials, could run afoul of the offering rules.⁷

Another significant advantage of WKSI status is the greater flexibility in registering securities offerings under a more streamlined process known as automatic shelf registration. Under this process, WKSIs can register securities offerings on shelf registration statements that become effective automatically upon filing.⁸ Automatic shelf registration affords WKSIs immediate effectiveness for their registration statements, so there is no delay going to market.⁹

Moreover, WKSIs can effectively register an unlimited amount of securities to be sold for an unlimited period of time. In other words, it can add securities to its registration statement as the need arises.¹⁰

CANADIAN PROPOSAL

The following excerpt reproduces the Taskforce’s proposal regarding WKSI:

⁴ *Securities Offering Reform*, *supra* note 3 at 24.

⁵ Adam Barone, “Regulated Investment Company (RIC)” (17 April 2020), online: *Investopedia* <<https://www.investopedia.com/terms/r/ric.asp>>.

⁶ *Securities Offering Reform*, *supra* note 3 at 51.

⁷ Adam C Pritchard, “Well-Known Seasoned Issuers in Canada” (2006) University of Michigan Law School Scholarship Repository at 7.

⁸ *Securities Offering Reform*, *supra* note 3 at 23.

⁹ Pritchard, *supra* note 7 at 7.

¹⁰ Pritchard, *supra* note 7 at 9.

The Taskforce proposes that the *Securities Act* be amended to allow the OSC to develop a WKSI model in Canada to issue shelf prospectus receipts automatically for issuers that are above a certain public float or have issued debt securities above a set amount in a specified time period and have established an appropriate disclosure record.

The OSC should also consider implementing additional changes to the shelf prospectus system to provide similar accommodations to those available to WKSIs in the United States.

This would streamline the shelf prospectus process for such large issuers who meet the prescribed thresholds and make it more cost-efficient for such issuers to raise capital in Ontario's capital markets.

The Taskforce's proposal largely replicates the SEC's approach and accords similar benefits to WKSIs. Moreover, the Taskforce raised the question of what the appropriate market capitalization and debt offering thresholds should be for an issuer to qualify for WKSI status in Canada. The rest of this paper will focus on the two thresholds.¹¹

MARKET CAPITALIZATION THRESHOLD

The hypothesis is that, because Canadian companies are on average smaller than U.S. companies, the market capitalization threshold for the Canadian WKSI category should be lower than the U.S. standard. According to our research, the \$700 million market capitalization threshold should be maintained for Canadian public companies.

The definition of market capitalization requires the calculation of a candidate company's worldwide market value. We will use companies' market capitalization on North American exchanges as a proxy to determine whether it meets the \$700 million cutoff. Due to this approximation, our results may be underinclusive of the members of the WKSI class.

APPLYING THE U.S. THRESHOLD TO THE CANADIAN MARKET

Looking at all U.S. exchanges collectively, a total of 19,346 companies are listed, of which 18,015 are eligible in that they are not registered investment companies. With a \$700 million market capitalization cutoff, 32% of the listed companies are large enough to qualify as WKSI. These companies together represent 98% of the total market capitalization of the U.S. equity market.

Looking at all Canadian exchanges collectively, a total of 4,087 companies are listed, of which 3,235 companies are eligible. If a \$700 million market capitalization cutoff is applied, only 9% of

¹¹ *Consultation Report*, *supra* note 2 at 16.

the listed companies are large enough to qualify as WKSI. However, these companies together represent 94% of the total market capitalization of the Canadian equity market.

Looking at only the companies listed on the Toronto Stock Exchange (TSX), a total of 1,634 companies are listed, of which 796 companies are eligible. If a \$700 million market capitalization cutoff is applied, 33% of the companies listed on the TSX would be large enough to qualify as WKSI. These companies together represent 96% of the total market capitalization of the TSX.

Table 1¹²

	19,346	18,015	5,740	31.97%	98.45%
	4,087	3,235	283	8.75%	93.81%
	1,634	796	262	32.91%	96.26%

All constituents of the S&P/TSX60 Index are large enough to qualify for WKSI status. Only one constituent is a REIT and is therefore ineligible. The S&P/TSX Composite Index has 221 constituents as of the date of research. Approximately 20 constituents are REITs and are ineligible. Of the eligible companies, only one does not meet the \$700 million market capitalization threshold. The company is Sienna Senior Living Inc., and it has a market capitalization of \$697 million.

ADJUSTING THE THRESHOLD?

The presumption is that, since Canadian companies are on average smaller than U.S. companies, the Canadian WKSI category should have a lower market capitalization threshold. Comparing the companies listed on All U.S. Exchanges and All Canadian Exchanges, it is plain that the average Canadian company is smaller than the average U.S. company.

However, if we compare the figures from All U.S. Exchanges to the TSX, the percentage of WKSIs (32% and 33%) and the percentage of market capitalization represented by WKSIs (98% and 96%) are strikingly similar. This suggests that the companies listed on the TSX, which are the biggest Canadian companies, resembles the size and distribution of the companies listed on All U.S. Exchanges. By extension, there are a large number of very small companies listed on Canadian exchanges other than the TSX.

¹² Data obtained from Capital IQ unless otherwise specified.

The graphs below illustrate the distribution of U.S. companies and Canadian companies in terms of market capitalization. The tables show the number and percentage of companies in each market capitalization bracket. The histograms depict the same information.

Table 2 – Distribution of U.S. Public Companies by Market Capitalization

<i>Mrk Cap (million)</i>	<i>Number of Companies</i>	<i>Cumulative Percentage</i>
0	1,856	10.30%
0 – 100	7,307	50.86%
100 – 200	1,142	57.20%
200 – 300	667	60.90%
300 – 400	508	63.72%
400 – 500	414	66.02%
500 – 600	279	67.57%
600 – 700	267	69.05%
700 – 800	232	70.34%
800 – 900	183	71.36%
900 – 1,000	170	72.30%
1000 – 2,000	1,118	78.51%
> 2,000	3,872	100.00%
TOTAL	18,015	

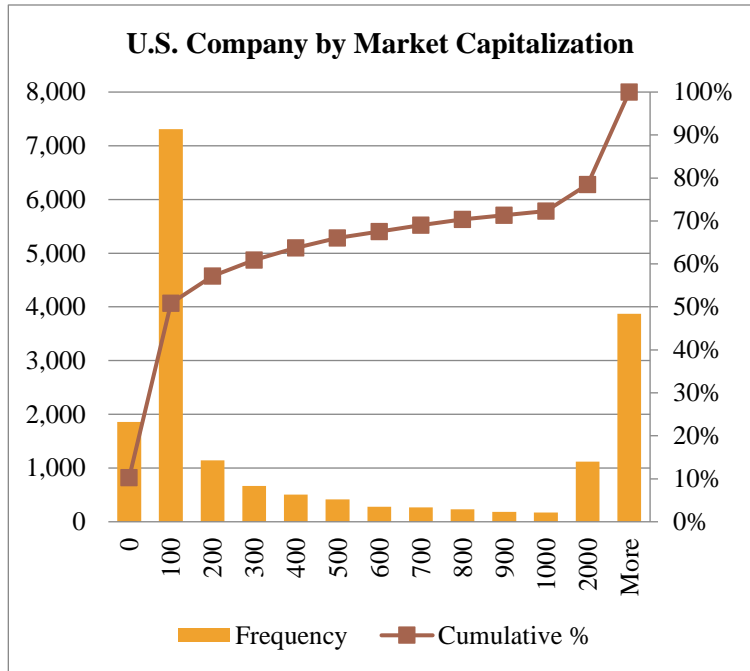
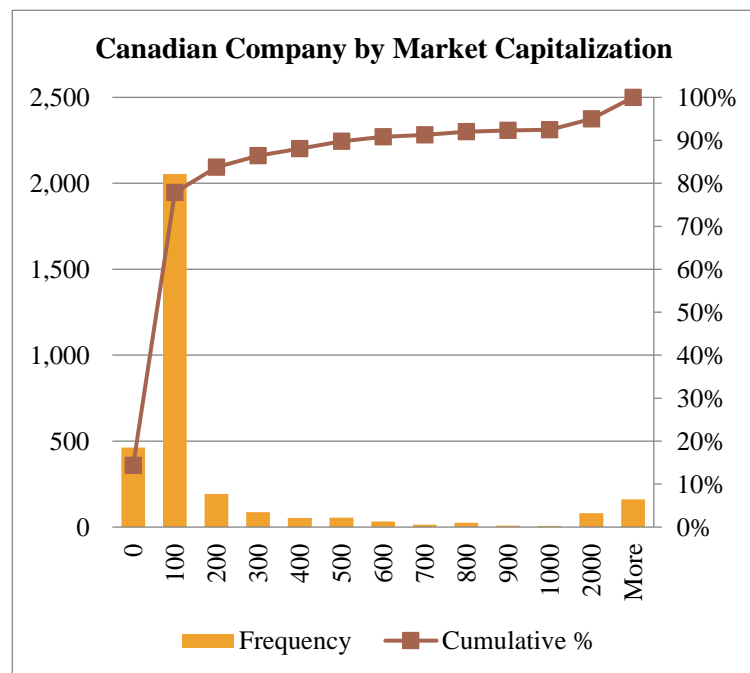


Table 3 – Distribution of Canadian Public Companies by Market Capitalization

<i>Mrk Cap (million)</i>	<i>Number of Companies</i>	<i>Cumulative Percentage</i>
0	463	14.31%
0 – 100	2,055	77.84%
100 – 200	192	83.77%
200 – 300	87	86.46%
300 – 400	53	88.10%
400 – 500	55	89.80%
500 – 600	33	90.82%
600 – 700	14	91.25%
700 – 800	25	92.02%
800 – 900	9	92.30%
900 – 1,000	6	92.49%
1000 – 2,000	81	94.99%
> 2,000	162	100.00%
TOTAL	3235	



Canada has a higher percentage of small public companies. U.S. companies with market capitalization below \$100 million represent 50% of all listed companies. Canadian public companies with market capitalization below \$100 million represent almost 80%. Moreover, Canada has a lower percentage of large companies. U.S. companies with a market capitalization above \$1 billion represent 22% of all listed companies. In Canada, this number is 5%.

If we adjust the WKSI market capitalization threshold for Canada, what would we adjust it to?

First, what would the market capitalization threshold be if 30% of companies listed on All Canadian Exchanges were captured as WKSIs? By looking at the company in the 30th percentile, the market capitalization would have to be as low as \$50 million, which is too small to even fit the plain and grammatical meaning of “well-known seasoned issuer.” Having a market capitalization cutoff that qualifies 30% of all listed companies would make no sense.

Second, because there are so few Canadian companies that are mid-sized, dropping the threshold to \$600 million or even to \$300 million would only add a very small number of companies, calling the usefulness of such adjustment into question.

Based on the above observation, we conclude that the market capitalization threshold for Canadian WKSIs should remain at \$700 million.

ADDITIONAL SUPPORT

The definition of WKSI should be closely connected to the idea of investor protection. WKSIs were given more favorable treatment not because their economic clout justifies relaxed regulation. WKSIs receive less regulatory scrutiny because they are presumed to be most closely followed by analysts and institutional investors and therefore already under scrutiny by numerous market participants.¹³ This raises the issue of the value added to investors from scrutiny by securities regulators of public offerings. If regulatory scrutiny adds little value, WKSI status should be extended quite broadly.¹⁴ To gauge investor protection, three indicators are worth examination: analyst coverage, trading volume, and institutional ownership.

All three factors had an impact on the SEC’s decision back in 2004 to adopt the \$700 million market capitalization threshold. Looking at the 2004 U.S. data, companies with market capitalization above \$700 million on average had 12 analysts, 52% of institutional ownership and daily trading volume of nearly \$52 million.¹⁵

The tables below show the current data for analyst coverage, average daily volume and institutional ownership of all the companies listed on All U.S. Exchanges and All Canadian Exchanges.

¹³ Pritchard, *supra* note 7 at 9.

¹⁴ *Ibid* at 13.

¹⁵ *Securities Offering Reform*, *supra* note 3 at 27.

Table 5: 2021 U.S. Data

Market Capitalization (\$ Million)	Mean # of Analyst	Avg Daily Volume (\$ Million)	Institutional Ownership
(1,000, 2,000]	7.5	13.42	48.24%
(900, 1,000]	5.9	8.99	42.43%
(800, 900]	5.6	10.31	44.55%
(700, 800]	5.4	7.14	42.27%
(600, 700]	4.5	10.53	39.83%
(500, 600]	4.4	5.15	36.46%
(400, 500]	3.8	9.32	33.42%
(300, 400]	3.0	4.02	30.51%
(200, 300]	2.6	2.67	26.48%

Table 6: 2021 Canadian Data

Market Capitalization (\$ Million)	Mean # of Analyst	Avg Daily Volume (\$ Million)	Institutional Ownership
(1,000, 2,000]	9.46	5.05	33.52%
(900, 1,000]	9.17	3.84	22.29%
(800, 900]	7.22	2.94	21.23%
(700, 800]	5.32	5.97	26.52%
(600, 700]	5.29	2.09	15.78%
(500, 600]	5.00	1.62	20.39%
(400, 500]	4.80	0.93	18.05%
(300, 400]	4.58	1.16	20.59%
(200, 300]	4.00	0.91	17.06%

While the contrast is less pronounced than in 2004, the \$700 million threshold is still supported in the U.S.: companies with over \$700 million market capitalization, on average, have over 5 analysts. These companies also on average have over 40% of institutional ownership.

In Canada, it is more difficult to discern a clear break in the data to identify an appropriate threshold. Looking at institutional ownership, a \$700 million threshold can be supported. Institutional ownership drops down from 27% to 16% once the company falls below \$700 million in market capitalization. The dollar amount of Average Daily Volume also supports a threshold of \$700

million. Alternatively, looking at the average number of analysts, a \$500 million threshold can also be supported. Companies with over \$500 million market capitalization on average have over 5 analysts. Smaller companies on average have less.

If a \$500 million market capitalization threshold were adopted, only 40 additional companies listed on the TSX and 7 additional companies listed on other Canadian exchanges will be captured by the WKSI category. This is not a pronounced change in the members of the WKSI class. In the spirit of investor protection, the evidence points towards setting the market capitalization threshold at \$700 million.

DEBT ISSUANCE THRESHOLD

The debt issuance threshold has less significance than the market capitalization threshold. It captures only a small population of companies. Most companies that have issued over \$1 billion of debt securities in the past three years would also have a market capitalization above \$700 million. This category is only relevant to companies with less than \$700 million in market capitalization.

We looked at public debt issuances in the past three years from companies registered in Ontario. We found 868 debt issuances from 136 different companies, two of which are REITs. Of the 134 eligible companies, most have already passed the market capitalization threshold.

The \$1 billion debt issuance threshold is also appropriate for the Canadian marketplace. 20 companies have issued over \$1 billion in debt but have less than \$700 million in market capitalization. If the debt issuance threshold is dropped down to \$500 million, then 30 issuers would be captured.¹⁶ Cutting the debt issuance threshold by half only to extend the WKSI status to 10 companies is not a proportional tradeoff. We recommend maintaining the \$1 billion cutoff.

A number of companies captured by the debt issuance threshold are subsidiaries of foreign companies, such as Toyota Credit Canada Inc., Ford Credit Canada Co., Honda Canada Finance Inc. The parent company of these subsidiaries are likely WKSI in either the U.S. or its home jurisdiction. Extending them WKSI status in Canada is appropriate and does not present unreasonable risks to investors.

SUMMARY

Market participants within Ontario have indicated to the Taskforce that regulatory burden is stifling innovation and competitiveness in Ontario's capital markets. Market participants have long called for a more flexible regulatory approach to enable Ontario to compete globally.¹⁷

¹⁶ Data obtained from Bloomberg.

¹⁷ Ontario, "Capital Markets Modernization Review" (6 February 2020), online: *Ontario* <<https://news.ontario.ca/en/backgrounder/55670/capital-markets-modernization-review>>.

In adopting the WCSI category, Ontario should maintain the \$700 million market capitalization threshold and the \$1 billion debt issuance threshold. While Canadian companies are on average smaller than U.S. companies, we should focus solely on large Canadian companies when designing the WCSI thresholds. The suggested thresholds would accord WCSI status to a meaningful portion of large Canadian issuers without reducing the strength of investor protection.