

**BRIEFING NOTE**

# Will mandatory sustainability disclosures strengthen Canada's capital markets?

April 2026





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# EXECUTIVE SUMMARY

Canada is at a pivotal moment in the evolution of sustainability and climate-related disclosure.

Globally, investors increasingly treat climate risks as material, and regulators are moving toward standardized sustainability reporting frameworks, particularly in Europe and Asia. Within this broader shift, Canada has established the core building blocks of a modern disclosure regime, most notably the Canadian Sustainability Standards Board's (CSSB) internationally aligned disclosure standards, but these standards remain voluntary. At the same time, recent policy developments to combat greenwashing (Bill C-59) have weakened incentives for voluntary disclosure. The Canadian Securities Administrators' (CSA) market-wide initiative to mandate climate-related disclosure was paused in April 2025 due to competitiveness concerns.

The result is a fragmented disclosure landscape at precisely the moment markets are demanding more consistent, decision-useful information.

This briefing note assesses the likely impact of a mandatory sustainability disclosure regime on Canadian capital markets, using (1) early evidence on sustainability reporting mandates and voluntary reporting, and (2) lessons from major historical reforms that addressed harmful gaps in financial and governance reporting (e.g., U.S. Securities Acts Amendments in 1964 targeting Over-the-Counter (OTC) markets, the *Sarbanes-Oxley Act* of 2002, adoption of the International Financial Reporting Standards (IFRS), and the *Dodd-Frank Act* of 2010). The core policy tension is straightforward: better disclosure improves risk pricing and market efficiency, but compliance costs and distributional impacts are real, especially for smaller firms and emissions-intensive sectors that still provide essential goods and services.

## What the evidence suggests: likely market impacts

Across the literature reviewed, the direction of effects is broadly consistent:

- **Sustainability disclosure is treated as decision-useful and often financially material.** Evidence on voluntary reporting suggests that firms with stronger ESG performance can reduce their cost of capital by disclosing, implying that investors value this information in financing decisions. However, this also creates self-selection: better performers disclose more, while weaker performers may remain opaque.
- **Mandatory disclosure changes market-wide incentives by making weak performers visible.** Early evidence on mandates indicates an initial net cost on average, but those costs are concentrated among weaker ESG performers. When disclosure becomes standardized and comparable, markets can reprice firms more accurately by exposure to climate-related risks, rewarding credible strategies and penalizing unmanaged risk.
- **Capital market quality can improve through familiar channels.** Studies of mandatory ESG regimes point to improvements in liquidity, price informativeness, and the informational environment for analysts.
- **Incentive changes are part of the policy objective.** Mandates can do more than reveal risk: they can spur firms to improve performance (e.g., emissions reductions and governance upgrades) because policy signalling, peer benchmarking, and public scrutiny increase the payoff to credible transition planning.
- **Costs of compliance may be large and uneven.** Major reporting reforms have repeatedly produced substantial upfront costs (including assurance and systems-building), with disproportionate burdens on smaller firms and firms starting without reporting infrastructure. While costs often decline as expertise and processes mature, initial impacts can be material.
- **Listing competitiveness matters.** If requirements are perceived as more onerous than peer jurisdictions, some firms may seek to list elsewhere or delay going public; however, historical evidence suggests the relationship is complex and often intertwined with broader market conditions.

- **Litigation risk is real but not mechanically driven by “more disclosure.”** Evidence from past reforms suggests litigation spikes can be temporary. Litigation risk, however, often correlates with overly optimistic claims and contradictions rather than disclosure volume itself. In the Canadian climate context, rising greenwashing scrutiny due to changes to the *Competition Act* under Bill C-59 may create incentives for vaguer, less verifiable voluntary disclosure – which strengthens the case for standardized requirements that specify what must be reported and how.

### **Bottom line for Canada**

The literature suggests Canada should expect initial net costs, but also a meaningful structural shift in incentives: firms with strong governance and credible transition strategies are likely to be rewarded over time through improved market confidence and potentially lower financing costs. Overall, the evidence supports the conclusion that with the right policy design, Canada can develop an effective disclosure regime that mitigates costs, while providing better climate risk oversight.

- See our [Summary insights for Canadian regulations](#)

# INTRODUCTION

As investors increasingly find climate-related risks salient and material, there has been a global push for stronger, more standardized sustainability disclosures by firms (TCFD, 2017). The growing trend to incorporate environmental considerations is evident across a variety of indicators: assets under management in sustainability funds reached US\$3.5 trillion in 2025, revenue for ESG data providers grew from US\$245 million in 2016 to US\$1.56 billion in 2024, and the number of firms reporting through CDP's independent environmental disclosure data system increased from roughly 5,000 in 2014 to over 22,400 in 2024. Multiple jurisdictions are now also in the process of incorporating sustainability-related disclosures into domestic regulation, with 37 jurisdictions adopting or in the process of adopting the International Financial Reporting Standards' (IFRS) Sustainability Standards (Berg, 2025).

Among IFRS adopters, Canada sits at a crossroads. The Canadian Sustainability Standards Board (CSSB) has finalized the Canadian Sustainability Disclosure Standards (CSDS) 1 and 2, which are aligned to the international sustainability standards (IFRS S1 and S2). However, these standards remain voluntary. Problematically, amendments to the *Competition Act* that came into effect in June 2024 intended to address corporate greenwashing negatively impacted incentives to voluntarily report ESG data, leading some firms to pull their sustainability reports and others to reduce the depth of the data provided (Millani, 2025). While the Canadian securities regulator, the Canadian Securities Administrators (CSA) initially indicated that it would pursue its own process to mandate the standards, which would have helped preserve the quality of information in the market, it has since paused the initiative as of April 23, 2025. In recent months, a number of investor groups have pressed regulators to resume the process (BMKP, 2025; Ellmen, 2025).

The policy problem for mandating sustainability disclosures is as follows. A disclosure mandate requires firms to build their climate-reporting capabilities. However, compliance costs are uneven. Organizations with existing reporting infrastructure face lower burdens than firms starting from scratch.

Once disclosures are in place, markets can observe and price exposure to physical and transition climate risks<sup>1</sup>. This improves risk pricing in two ways. First, better information reduces uncertainty and leads investors to reprice firms based on existing risk exposures. Second, the mandate itself can shift expectations by signalling that climate risks will be a priority for regulators, increasing the perceived weight of transition risks and raising required returns for more exposed firms. That effect is by design: it strengthens incentives to manage climate risks and align to a net-zero pathway. Nonetheless, it also raises serious concerns about compliance costs and the long-term financial impact on some of the higher-emitting sectors, many of which still provide essential goods and services to Canadians.

We conduct a literature review of studies examining the impact of sustainability disclosures and supplement them with studies that reflect on the effects of prior financial and governance-related disclosure mandates (e.g., U.S. Securities Acts Amendments in 1964 targeting Over-the-Counter (OTC) markets, the *Sarbanes-Oxley Act* of 2002, adoption of the International Financial Reporting Standards (IFRS), and the *Dodd-Frank Act* of 2010) to infer insights on how a mandatory sustainability disclosure regime might impact Canadian capital markets.

This Briefing Note proceeds in five main sections. Section one provides a primer on the value of disclosures. Section two describes our research design and its limitations. Section three synthesizes evidence on how voluntary and mandatory sustainability disclosure affects risk pricing and firm incentives. Section four examines the trade-offs associated with a disclosure mandate. Section five summarizes key insights for Canadian regulators.

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1 Physical risk refers to potential harm to operations, supply chains etc. from changes to the environment and climate related weather events such as fires, floods and droughts. Transition risk refers to business risk from a changing policy or regulatory environment as governments prioritize decarbonization.

# THE ROLE OF DISCLOSURE IN RISK MANAGEMENT

Markets are imperfect, a phenomenon which can be partially explained by informational asymmetries. Informational asymmetries happen when one side of a financial transaction has better information than the other. In markets, this often means company insiders and managers know more about a firm's true condition, its risks, strategy, and performance, than outside investors do. Information gaps lead to mispriced risk, whereby investors hold required returns for investments that do not efficiently capture a firm's risk exposure.<sup>2</sup>

## Box 1: Information gaps

When firms disclose their exposure to climate-related risks and their strategies for managing them, markets can incorporate these risk signals into pricing and capital allocation. In the absence of such credible, decision-useful information, investors face greater uncertainty, which can lead to unforeseen shareholder losses, raise the cost of capital and impede market efficiency.

### Example 1: Hidden physical risk and operational disruption

A beverage company draws most of its water from a single basin but does not report that the region is getting drier or that it lacks contingency plans. When the local government imposes water restrictions, production drops, catching stakeholders off guard. Because the risk was not disclosed, investors could not assess the likelihood or financial magnitude of disruption, contributing to shareholder losses. Disclosing water dependence and adaptation measures (e.g., alternative sourcing, conservation investments, scenario analysis, and trigger points for operational changes) would help stakeholders assess earnings resilience, price risk more accurately, and incentivize better risk management decisions.

### Example 2: Interpreting the risks of non-disclosure

In a country widely viewed as climate-vulnerable, climate reporting remains voluntary and uneven. Some firms publish detailed risk assessments; others disclose little. Some firms believe they are insulated from climate risks and choose not to disclose to avoid reporting costs. But investors interpret non-disclosure as a red flag and apply an uncertainty premium, raising required returns and lowering valuations for non-disclosers. Consistent, comparable disclosure would allow investors to distinguish resilient firms from exposed ones, reduce information asymmetry, and price risk more accurately. This would reward firms with robust climate-risk governance and credible transition strategies with a lower cost of capital.

Disclosure is the primary mechanism markets use to reduce these information gaps. Disclosures are the information a company shares with investors, through financial statements, regulatory filings, sustainability reports and other updates about its financial results, risks, governance, and outlook. Credible and comparable disclosures function like market infrastructure: they help investors and regulators monitor firms, price risk, and distinguish resilient business models from fragile ones. Studies link disclosure to more efficient markets, characterized by changes in cost of capital for firms that better account for risk exposures, improved liquidity, lower stock price synchronicity<sup>3</sup>, and greater foreign investment.

<sup>2</sup> Research indicates that markets price risks associated with informational asymmetry. See Lambert et al. (2007); Easley & O'Hara (2005).

<sup>3</sup> Stock-price synchronicity refers to price informativeness or the degree to which changes in stock prices are explained by market and industry factors rather than firm-specific factors.

Historically, major disclosure mandates have often followed periods when markets discovered, sometimes abruptly, that critical information was missing. In the United States, securities laws in the 1930s expanded mandatory disclosure after the Great Depression, and later reforms extended oversight to less transparent corners of the market (e.g., the OTC market in the 1960s). Corporate scandals such as Enron and WorldCom exposed failures in governance and internal controls, prompting *Sarbanes-Oxley* (2002), while the Global Financial Crisis highlighted hidden risks in the financial system and led to reforms such as *Dodd-Frank* (2010), including enhanced reporting in areas like derivatives and compensation.

At the same time, disclosure mandates may be extremely costly. Regulators must ensure that disclosure mandates provide markets with *additional* and *material* information to ensure that the capital market benefits outweigh any costs. Policy debates around the implementation of each of the mandates listed above included three interrelated arguments against mandated disclosures:

1. Mandated disclosures may deter listings or drive firms private.
2. Costs may outweigh benefits, especially for smaller enterprises.
3. Additional disclosure may spur litigation risks.

As a result of these debates, a substantial volume of research explores the impacts of mandated disclosures.

## RESEARCH DESIGN: INSIGHTS AND LIMITATIONS

This paper infers how a mandatory sustainability disclosure regime might affect Canadian capital markets using literature on prior accounting mandates, but several limitations temper our conclusions. First, across the literature, authors have highlighted the challenges associated with isolating the effect of any given accounting mandate and establishing a causal relationship with subsequent outcomes. Disclosure reforms are often introduced alongside other policy interventions, in response to macroeconomic or institutional shocks, and within legal environments that evolve over time, so lurking and confounding variables may drive part of the documented effects (Leuz & Wysocki, 2016).

Second, this paper extrapolates from evidence on earlier financial-reporting and governance disclosure mandates to assess the likely effects of sustainability disclosure requirements. While this comparison is useful, the size of effects may not correspond directly. Sustainability disclosures differ in content from earlier mandates and may therefore influence firm behaviour and investor pricing through distinct channels. These dynamics are also shaped by an evolving legal and political environment for climate-related reporting. As a result, the findings should be interpreted as indicative rather than definitive outcomes of a Canadian sustainability disclosure mandate. Our goal is not to quantitatively estimate the impacts of a sustainability disclosure mandate but rather to understand the likely direction of impacts that it would have on Canadian capital markets.

# HOW SUSTAINABILITY DISCLOSURE SHAPES CAPITAL MARKETS AND INCENTIVES

This section begins by asking whether markets view sustainability disclosure as *additional* and *material*. If so, disclosure should affect firms' financing terms (cost of capital). When these effects occur broadly across firms, they can reshape market incentives by encouraging climate accountability and action.

We start with evidence on voluntary disclosure and then assess how a mandatory regime could structurally shift incentives across the market and improve market efficiency. The subsequent section examines the key trade-offs policymakers must navigate when designing and implementing disclosure mandates.

## DO MARKETS VALUE SUSTAINABILITY INFORMATION? EVIDENCE FROM VOLUNTARY DISCLOSURE

One indicator that markets value sustainability data is whether disclosure measurably affects financing terms such as the cost of equity or debt. The literature largely supports this proposition, but it also points to two important qualifications: the benefits of disclosure are often concentrated among stronger ESG performers, and the magnitude of pricing effects varies across institutional settings.

There are a number of studies that link voluntary disclosures to changes in the cost of capital. ESG ratings provider MSCI found that firms that were more resilient to climate risks (held higher ESG ratings) consistently benefited from lower cost of capital (Lodh, 2020; Malich, J., & Husi, 2024).

These findings are also largely corroborated by academic findings. For example, according to Dhaliwal et al. (2011), firms with strong ESG performance strategically begin voluntary reporting in order to reduce their cost of capital. Their study finds that there are no comparable benefits for firms with poor ESG performance. Raimo et al. (2021) explore the relationship between sustainability disclosures and the cost of debt for firms globally, concluding that firms with better sustainability disclosures have lower financing costs. Focusing specifically on Chinese listed firms, Shao & Xue (2024) also find that voluntary disclosure is associated with positive stock price reactions. A second study by Dhaliwal et al. (2014) expands the scope of the previous study to international firms and finds that sustainability reporting has a stronger impact on cost of capital in countries that are more stakeholder oriented (jurisdictions that also give weight to the interests of affected parties that are not shareholders), and where financial reporting is more opaque.

These studies suggest not only a process of self-selection, whereby stronger performing ESG firms are more likely to report, but also that the institutional environment will play an important role in dictating where such incentives are likely to be strongest.

Another set of studies demonstrate that investor perceptions about ESG alignment are also priced. Matsumura et al. (2014) find that firms in the S&P 500 that disclosed emissions had higher valuations with median market values US\$2.3 billion higher than comparable non-disclosing firms, while controlling for size and other factors. The authors found that disclosing firms were penalized with a US\$212,000 decrease in firm value per 1,000 metric tons of emissions, suggesting that markets treat emissions as an economic liability, penalizing higher emissions. El Ghouli et al. (2011) find that firms that have high ESG scores are rewarded with lower costs of capital, while companies that operate in more ESG-controversial areas (in their particular study, tobacco and nuclear)<sup>4</sup> have higher costs of capital. These studies indicate that emissions intensity, the availability of sector-specific decarbonization pathways, and investor perceptions of ESG alignment are also likely to impact whether firms will have an incentive to report and manage their climate risks.

Finally, it is worth noting that the evidence is not always clear-cut. Notably, some of the early evidence that empirically justified the value of sustainability disclosures has come into question. For example, the influential study by Cheng et al. (2014) which found strong evidence that firms with strong ESG performance have better access to capital has been disputed by King (2025).

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4 Nuclear has since become a more socially accepted industry and is no longer considered as controversial.

Regardless, most studies continue to find that sustainability disclosures improve the availability and quality of information, which is associated with a lower cost of capital for firms with stronger ESG performance. This relationship suggests that investors treat sustainability information as decision-useful, and in many cases financially material. That premise is a useful starting point for our analysis: it implies that disclosures close meaningful information gaps, and it motivates a careful evaluation of whether a reporting mandate would deliver net benefits once compliance costs are weighed against potential market gains.

## **WHAT IS CHANGED BY MANDATES: DISTRIBUTIONAL EFFECTS, BENCHMARKING AND INCENTIVES**

When a disclosure mandate is in effect, policymakers are signalling that investors should pay greater attention to sustainability indicators. Accordingly, markets will use the newly available data to inform their capital allocation decisions, amplifying any effects on firms' cost of capital. A number of studies demonstrate these effects.

Grewal et al. (2019) examined the market reaction to European Union (EU) Directive 2014/95, which mandated ESG disclosures across sectors, and found that although the regulation imposed net costs on firms, leading to an average negative abnormal return of -0.79% for affected firms, "negative returns are concentrated in firms with weak ESG performance and disclosure" (p. 3062). Firms with above-median performance are rewarded with a positive abnormal return of 0.52%.

Tomar (2023) examines the U.S. GHG Reporting Program and finds that public disclosures prompted firms to reduce their facility-level emissions by almost 8%, as peer benchmarking spurred investments to improve carbon intensity. Kim et al. (2023) also find evidence that disclosures incentivize improved environmental performance by examining the impact of Securities and Exchange Commission (SEC) guidance, issued in 2010, which clarified that firms must disclose material climate-related risks. Bassen et al. (2025) further support these findings by examining the EU taxonomy. The study documents a negative five-day average abnormal stock return of -0.43% around the day that the taxonomy was announced, but firms with higher taxonomy-aligned revenue recorded positive abnormal returns of 0.66%. A one standard deviation increase in taxonomy-aligned revenue earns a positive abnormal return of 0.30% per month when controlling for other factors. These studies clearly demonstrate that disclosure mandates reward strong ESG performers and create incentives for firms to improve their sustainability practices.

Importantly, the evidence also suggests that firms that improve disclosed performance can be rewarded through subsequent reductions over time for initially elevated costs of capital, reinforcing the view that disclosure requirements reshape incentives. To take an example outside of sustainability disclosures, the *Sarbanes-Oxley Act* mandated disclosures on internal controls and the efficiency of governance mechanisms, allowing investors to identify and price the risks associated with any existing governance deficiencies. Ashbaugh-Skaife et al. (2009) examine U.S. firms that disclosed at least one internal control deficiency. After disclosure, there was an immediate reduction in affected stock prices by an average of -0.76% and the cost of capital increased by 93 basis points for these firms. However, firms that improved their internal controls were rewarded with subsequent reductions in the costs of capital ranging from 50-150 basis points.

Given the examples above, although net costs are imposed when disclosures are mandated, there is clear evidence that these costs will play a role in shifting incentives for firms to prioritize ESG disclosure and performance.

## **REPORTING MANDATES AND MARKET EFFICIENCY**

As the quality of information in markets improves, there are benefits to the overall efficiency of markets. Disclosure mandates affect capital markets through familiar channels: greater price informativeness, a reduction in analyst errors, and improved liquidity. Unsurprisingly, empirical studies on reporting mandates often find links to more efficient markets. However, because regulatory changes frequently coincide with other reforms and shifting economic conditions, isolating the causal effect of a disclosure mandate is difficult, and the findings should be interpreted with appropriate caution.

Grewal et al. (2021) investigate the impact of sustainability disclosures on stock price synchronicity, which captures the degree to which stock prices are driven by market- and industry-wide factors rather than firm-specific information, with lower synchronicity indicating greater price informativeness. The authors find that the stock prices of firms that disclose against SASB indicators have lower stock price synchronicity. Critically, they also find that non-material disclosure does not generate the same improvement, underscoring that the benefits of sustainability reporting depend on the decision-usefulness of disclosed data. Yet the question of what types of sustainability information are material remains unsettled. For example, a working paper by Brié et al. (2025) adds nuance to the debate by finding that markets may not consider estimates of climate-related financial impacts as material unless those costs are near-certain and imminent. The authors conclude that regulators should reconsider whether these indicators should be part of disclosure mandates globally.

Mandatory sustainability disclosure also appears to improve the informational environment for analysts. Acheampong and Elshandidy (2025) find that sustainability disclosures, such as those associated with EU Directive 2014/95, reduce analyst errors and improve forecast accuracy. This relationship has been proven in other jurisdictions as well. Zúñiga et al. (2020) come to a similar conclusion when looking at South Africa. Lastly, Krueger et al. (2024) examine global firms and found a positive relationship between mandatory ESG disclosure and liquidity. They conclude by explaining that “these findings encourage and support regulatory changes for countries that have yet to adopt mandatory ESG disclosure requirements.”

Some studies also support a link between disclosure and stock market development. La Porta et al. (2006) conducted an analysis of securities laws in 49 countries. They constructed indices for mandatory disclosure, private enforcement (liability standards) and public enforcement (regulator independence, investigative powers, and criminal sanctions), and examined their relationship with stock-market development. Their seminal work finds that standardized disclosure mandates and private enforcement are strongly and consistently associated with larger markets, more Initial Public Offerings (IPOs), higher liquidity, lower block premia,<sup>5</sup> and less ownership concentration.<sup>6</sup>

Another complementary analogue is the global adoption of IFRS, which aimed to improve reporting comparability and support cross-border investment. IFRS adoption has been associated with several capital market benefits, including a reduction in the cost of equity for some firms (Li, 2010; Daske et al., 2008), improved liquidity (Daske et al., 2008; Leuz and Verrecchia, 2000; Welker, 1995), reduced stock-price synchronicity (Haggard et al., 2008), a reduction in analyst errors (Horton et al., 2013), and an increase in foreign institutional holdings, which indicates greater overall investor confidence (DeFond et al., 2011; Florou & Pope, 2012).

Focusing specifically on the link between institutional investors and sustainability disclosure, Gibbons (2024) finds that mandatory disclosure of environmental and social information across 40 countries is associated with significantly greater institutional investment. The paper further suggests that this change in the investor base helps firms increase research and development spending and issue more equity capital.

However, as several authors caution, some of the benefits of disclosure mandates may be due to other factors such as concurrent institutional improvements, the level of enforcement, and the relative scale of change in information quality (Defond et al., 2011; Florou & Pope, 2012; Leuz & Wysocki, 2016). For example, countries that already had high-quality reporting saw limited benefits from adopting IFRS. Synthesizing a decade of research, De George et al. (2016) find that researchers have mixed conclusions about the impact of IFRS adoption on accounting quality and comparability, due at least partly to the difficulties in attributing changes directly to IFRS adoption.

Finally, it is worth noting again that disclosure mandates are often introduced when information failures undermine trust in markets. Taken together, this evidence suggests that mandatory sustainability disclosure can support market development by improving the quality and quantity of information available to investors. The following section examines key tensions with a sustainability disclosure mandate. In particular, we examine the arguments relating to whether the costs of a disclosure mandate are too high and whether such mandates raise litigation risks unreasonably.

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5 The premium associated with purchasing a controlling share in a firm.

6 The authors address reverse causality in two distinct ways. First, they argue that since stock market development has a stronger relationship with low-cost statutory changes (mandated disclosure; investor-friendly liability rules) rather than more costly institutional arrangements (public enforcement), it suggests that the direction of the relationship logically flows from regulation to stock market development. They further corroborate this assumption by using legal origin as an instrumental variable for an investor-protection index and find that the results hold.

## COSTS AND TRADE-OFFS IN SUSTAINABILITY DISCLOSURE

Having established the channels through which disclosure can affect capital markets, the analysis now turns to the constraints and trade-offs that determine feasibility. Mandatory reporting is not costless: it requires data systems, governance, internal controls, and often third-party assurance, all of which can be disproportionately burdensome for smaller firms. If compliance costs are too high, firms may respond by delaying plans to go public, delist from Canadian exchanges, or seek alternative jurisdictions to raise capital. This section examines the evidence on direct and indirect compliance costs and what it implies for policy design.

### DIRECT COSTS OF COMPLIANCE

For disclosures to have a positive impact, they must raise the quality of information that is available to investors. We can expect a greater impact where informational asymmetries are greatest, for example among more opaque, smaller firms.

Stephen & de Jong (2012) illustrate this in their study on the *Sarbanes-Oxley Act*. While they find a net positive impact for firms on the S&P 500 Index and the S&P Small Cap 600 Index, they also find that smaller firms benefited most as they were initially more affected by information risk relating to internal controls.

Similar impacts were also recorded in the OTC market. The 1964 Securities Acts Amendments reformed the growing OTC market, where securities are traded directly between dealers rather than through a formal exchange. The reform required previously opaque firms to file periodic reports, leading to “a dramatic reduction in the volatility of OTC stock returns and with OTC stocks enjoying positive abnormal returns” (Ferrell, 2007, 213; see also Greenstone et al., 2006).

However, these firms also face disproportionately higher costs as compliance would account for a greater share of total revenue. These firms would have to rapidly invest in building their reporting capacity and expertise to adhere to the new regulations. If the costs of complying with the new disclosure regime are too high, firms may strategically delist and raise capital elsewhere.

Looking at the cost of compliance associated with *Sarbanes-Oxley*, IFRS adoption, and EU's sustainability reporting requirements, it becomes clear that such costs can escalate quickly.

*The Sarbanes-Oxley Act* introduced mandatory disclosures on internal controls, prompting concerns that smaller firms would remain private or delist to avoid the compliance burden. According to Iliev (2010), the costs of acquiring the assurance of management reports, a new requirement, were significant and negatively affected firm value. Financial Executives International (2005, as cited in Iliev, 2010) estimates that the total SOX Section 404 compliance costs, including internal labour and external assistance, average US\$2.3 million per year. He also shows that a portfolio of affected firms underperformed exempt peers on a risk adjusted basis, indicating a negative valuation effect beyond just the direct cost burden.

Pawsey (2017) provides a country-specific example and examines the cost of IFRS adoption in Australia. Pawsey finds that the costs of transitioning to IFRS were higher than expected. Firms took between one month and three years to transition, with firms taking an average of 16.85 months. The initial cost was between AU\$15,000 and AU\$9.5 million, with an average cost of AU\$518,000. Many firms also described a persisting increase in compliance costs, primarily because of the additional work involved in preparing financial statements and greater reliance on external auditors and consultants.

Many studies suggest that compliance costs peak in the year of mandatory disclosure legislation coming into effect. As markets adapt and the relevant experts develop the knowledge and skills required to ensure compliance, associated costs tend to fall rapidly. For example, following the *Sarbanes-Oxley Act*, Charles River Associates reports that the direct costs of compliance by Fortune 1000 companies fell by 15-40% in the second year, with subsequent reductions of 25% the following year (Coates and Srinivasan, 2014).

For larger firms, the costs of sustainability reporting may not require building reporting capability from scratch, because sustainability or climate reporting is already common among S&P/TSX Composite constituents (ISF, 2025). The incremental cost to align existing reporting practices with a disclosure mandate will vary significantly across firms, depending on the maturity of data systems, controls, and the extent of required disclosure.

The EU provides a useful analogue for what these alignment costs can look like for incumbent reporters. The Corporate Sustainability Reporting Directive (CSRD) required firms that previously reported under the Non-Financial Reporting Directive (NFRD) to transition and report under the European Sustainability Reporting Standards (ESRS). A cost-benefit analysis prepared for the European Financial Reporting Advisory Group (EFRAG) estimates that, for an average company that was already reporting under the NFRD, the incremental administrative cost associated with preparing sustainability statements in line with ESRS is roughly €287,000 in the first year, plus about €320,000 per year in recurring administrative costs after full phase-in. Limited assurance would add more than €360,000 per year, while reasonable assurance would likely add more than double that figure.

The same study also pointed out that there can be substantial indirect costs if accounting rules damage the competitiveness of affected firms. In the case of ESRS, most stakeholders did not perceive such harm because a level playing field was preserved and competitors were subject to the same rules (EFRAG, 2022).

Another mechanism by which competitiveness can be damaged is the loss of proprietary information. The findings of a working paper by Driss et al. (2025), suggest that firms which risk losing proprietary information through mandatory disclosures face higher costs of equity and lose firm value, and that on aggregate the “costs of mandated environmental disclosure outweigh any associated capital-market benefits.” However, as Christensen et al. (2021) point out, such costs only become relevant when disclosures are granular and detailed, as opposed to aggregated or high-level.

These papers suggest that mandatory disclosure requirements can facilitate stock market development by attracting more investors, but regulators must carefully consider compliance costs, as overly onerous requirements can influence firms to list elsewhere and conserve their capital to finance further growth rather than fulfil regulatory requirements. Additionally, regulators must be wary of indirect costs, which are not immediately observable, but nonetheless raise the costs of compliance significantly. For example, disclosure mandates must be carefully implemented to ensure that they do not impede the competitiveness of domestic firms.

## IMPACT ON STOCK EXCHANGE LISTINGS

Given the high potential costs of compliance, how then do firms respond when the costs are deemed too high internally? Will firms forgo listing in certain jurisdictions to avoid disclosure obligations? Since exchanges compete for listings, onerous regulations in one jurisdiction may lead firms to seek alternatives with a lower compliance burden.

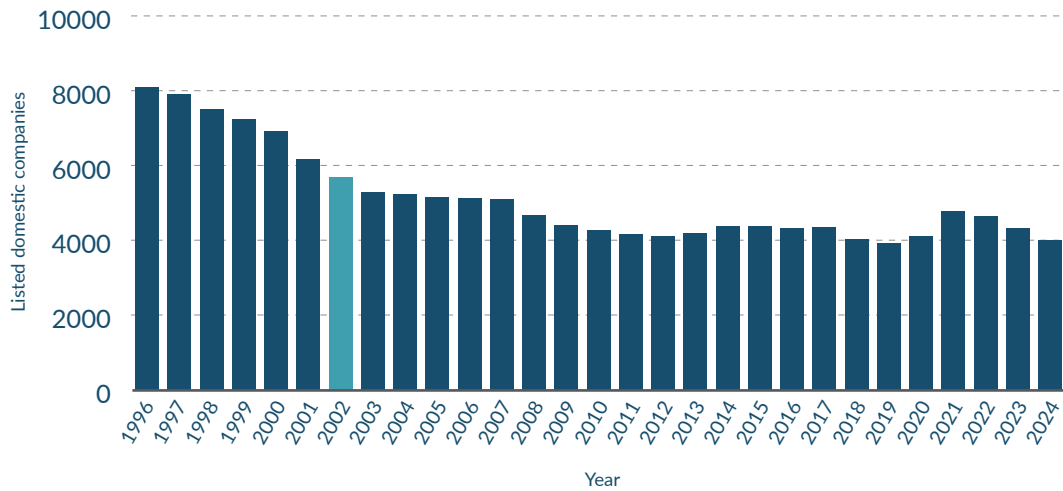
Several jurisdictions have recently reworked their listing regulations to improve the attractiveness of listing on local exchanges, demonstrating the urgency of limiting the regulatory burden on smaller firms. For example, an impact assessment in the EU revealed that excessive regulation was incentivizing firms to list in other jurisdictions, which led to a simplification of listing requirements for smaller firms (European Commission, 2022). Similarly, a review of listing requirements in the U.K. found that overly complex and costly requirements are “... playing a part in driving business to our competitors” (Hill, 2021, p. 2), leading to a similar simplification of regulations.

Research on the 2002 *Sarbanes-Oxley Act* is informative because it coincided with a decline in new listings, prompting studies of whether the disclosure costs were at fault (see [Figure 1](#)). However, the weight of evidence suggests that the drop in IPOs began before *Sarbanes-Oxley* and persisted even after small-issuer relief, pointing to other factors rather than the *Act* itself as the primary driver (e.g., Gao et al., 2013; Coates & Srinivasan, 2014). At the same time, IPO pricing appears to have improved with less volatile first-day returns, consistent with better information environments (Coates & Srinivasan, 2014; Johnston & Madura, 2009). Although some foreign firms chose to list elsewhere following the *Act*, there was a net increase in market capitalization, as firms that persisted were larger, making up for the loss of smaller, riskier firms (Coates & Srinivasan, 2014; Piotroski & Srinivasan, 2008). This is consistent with a repricing of risk; unprepared firms face higher costs to achieve compliance, whereas firms that are more prepared proceed with listing. It is important to note that listing in the U.S. is associated with a premium that may have alleviated negative impacts (Doidge et al., 2009). This premium may limit the generalizability of these findings to other jurisdictions.

One of the key lessons here is that policymakers should be aware of how compliance costs compare with other relevant jurisdictions, especially where defection is most likely, and ensure that an even playing field is maintained.

**FIGURE 1**

## Number of publicly listed domestic firms in the U.S. before and after Sarbanes-Oxley (2002)



Source: World Bank

## LITIGATION RISKS

Another concern with mandated sustainability disclosures is that it may provide ammunition for frivolous litigation (SIFMA, 2022; Milstead, 2022; Bracewell LLP, 2021). In this section, we examine literature on disclosure regulations and their impact on litigation risk.

Evidence suggests that climate-related litigation is an increasing risk for firms (Network for Greening the Financial System, 2021; Sato et al., 2024; Setzer & Higham, 2024), which has sparked concern that more disclosure may lead to more litigation. However, evidence clearly shows that litigation is driven not by an increase in the volume of disclosure, but rather by unexpected outcomes. For example, Rogers et al. (2011) find that litigation is more likely when managers are “unusually optimistic relative to other firms experiencing similar economic circumstances” or are “both unusually optimistic and engage in abnormal selling” (p. 2155).

As a result, timely disclosure of bad news can actually mitigate litigation risk (Field et al., 2005; Skinner, 1994). One example that demonstrates the spurious link between disclosure volume and litigation risk comes from the *Sarbanes-Oxley Act*. According to Coates and Srinivasan (2014), there was a rise in litigation immediately following the *Act*, but this rise was short-lived and quickly returned to pre-legislation levels soon after. They conclude that “the pattern is more consistent with large costs arising from the fundamental corporate misconduct that gave rise to [the *Sarbanes-Oxley Act*], followed by a reduction in that misconduct (at least as perceived by litigants and other participants in the legal system)” (p.643).

Relatedly, by making nonfinancial outcomes visible and comparable, mandatory reporting prompts firms to improve them. For example, the *Dodd-Frank Act* introduced two relevant disclosure rules: the Conflict Minerals Rule and the Mine Safety Disclosure Rule. The stock prices of firms that operated in areas associated with conflict minerals fell and the required disclosures on mine safety led to improvements in safety practices and outcomes (Christensen et al., 2017). These findings suggest that disclosures can incentivize firms to prioritize other socially desirable outcomes or manage externalities. As a result, one could argue that enhanced disclosure might lead to reduced litigation risks, as firms systematically evaluate how their operations potentially impact various stakeholders and improve their non-financial performance accordingly.

Regulation, however, can affect litigation risk and firm behaviour. Robinson et al. (2025) find that firms respond to an increase in perceived litigation risk, such as lawsuits against peers, by making “less verifiable disclosures” and shifting towards more forward-looking claims (p. 447). Thus, although Bill C-59 was passed in Canada to better allow firms with genuine climate commitments to differentiate themselves from greenwashers, the legislation increased perceived litigation and liability risks across the market and created the possibility that firms would retreat into more cautious, less specific voluntary disclosures. According to Millani (2025), this pattern may already be emerging. Millani states that “[w]hile most companies continued to disclose, the tone of reporting became noticeably more cautious, with some issuers removing forward-looking information such as GHG targets and scenario outcomes. The broader impact may lie not in the volume of disclosure but in its depth” (p. 6).

A mandatory, standardized regime could counter this drift by specifying what must be reported and in what form, sustaining specificity and comparability across firms. This will have the added benefit of complementing the greenwashing rules and helping firms with genuine climate strategies to stand out. Since Bill C-59 is already in effect, it may have accelerated the need for mandatory disclosures in Canada.

## SUMMARY INSIGHTS FOR CANADIAN REGULATIONS

The available evidence supports the thesis that markets do value sustainability information and markets price exposure to climate-related risks, often leading to rewards for firms with strong disclosure and ESG practices. However, the costs involved can be significant, requiring policymakers to find a sustainable balance between transparency and the reporting burden. Firms early in their sustainability transition face the highest compliance costs because they require the largest upfront investments to meet the standards. Moreover, firms that operate in ESG-controversial sectors and firms that lack net-zero pathways may also find their cost of capital negatively impacted.

While these factors generally lead to an initial net-negative impact on markets, firms that improve their disclosure practices and manage their exposure to climate risks will see subsequent reductions in their cost of capital. These findings are in line with the premise that disclosures shift the structural incentives so that firms are forced to address climate-related risks.

This section summarizes key policy insights from the literature.

### **Phase in disclosure mandates, starting with the largest firms**

Given past experience with significant new financial disclosure requirements discussed above, climate-disclosure mandates for Canadian firms should be rolled out in a phased manner, starting with the biggest firms so as not to burden small and medium-sized companies.

As we have seen, costs are front-loaded and generally fall over time. The large firms can easily handle the most material mandatory disclosures. Many already have the systems and resources in place as most are already reporting voluntarily.<sup>7</sup> Once these larger firms have implemented the rules and we've learned from their experience, the requirements may be extended gradually to smaller firms. Regulators should monitor compliance costs and consider whether to increase the number of in-scope firms accordingly.

### **Prioritize material and low-cost disclosures**

An important principle should be to prioritize the most financially material disclosures while exercising caution with indicators that are costly to produce. High-cost disclosures include metrics that could reveal proprietary information and harm competitiveness, as well as indicators that are less decision-useful or materially informative.

As a result, it may be reasonable to start with Scope 1 (emissions from the company's operations) and Scope 2 (energy-related emissions from heating and cooling etc.). Scope 3 or indirect emissions are complicated as firms are required to report on emissions throughout the entire value chain. ISF's research shows that reporting on material Scope 3 emissions, the most relevant value chain emissions sources for a firm's particular industry, is still very low. The more data we have from Scopes 1 and 2, the easier it becomes to estimate Scope 3, which is why the first two categories are so important. Regulators should roll out Scope 3 reporting once the data infrastructure and measurement practices are more mature.

Other commonly mandated items, such as financial impacts of climate-related risks and opportunities may also merit further study before their inclusion in the reporting mandate.

### **Monitor and improve the institutional environment**

A disclosure mandate may not have the desired effect on its own. There are number of institutional factors that help determine the effectiveness of the mandate. Policymakers should review the efficacy of past disclosure mandates, assess whether there were any barriers limiting the impact of those mandates, and implement additional supporting policies as necessary. For example, some jurisdictions may find it helpful to implement rules that empower stakeholders, improve enforcement of accounting rules, standardize disclosure formats and/or improve public access to reported data.

### **Schedule enforcement efforts strategically to limit listing flight and ease burden on smaller firms**

It is also important to keep in mind that firms strategically choose where to list, and smaller firms are more likely to see extensive disclosure requirements as a barrier. Regulators can strategically time the date of enforcement for mandatory disclosures in order to match peer jurisdictions and limit any competitive disadvantage.

<sup>7</sup> See ISF Report: [Canadian Corporate Performance on GHG Emissions, Disclosures and Target Setting: Fourth Edition](#)

## **Anticipate and mitigate uneven costs and benefits**

The research also shows that a disclosure mandate will reward firms with strong ESG performance and relatively low emissions, while others are penalized. This reflects a change in the overall incentive structure as capital markets factor in exposure to physical and transition risks. We can also anticipate potential uneven effects across the country, with companies in more resource-heavy Western Canadian provinces feeling a disproportionate impact. Although investors in high-emitting industries aren't blind to what they own, the adoption of mandatory disclosure can still carry weight as a policy signal, prompting investors to pay closer attention to their exposure to transition risks.

Policymakers should consult firms that are more likely to be negatively impacted and explore options to reduce impacts and provide resources to help them improve sustainability disclosure and performance. In addition, targeted support, such as guidance, training, and technical assistance can be provided to help firms close capability gaps, improve sustainability reporting and performance over time, and reduce any associated cost-of-capital penalties.

To mitigate the negative impact on high-emitting sectors, policy makers could develop tools that help investors understand how high-emitting sectors fit into Canada's long-term net zero strategy, such as a federally endorsed taxonomy. The absence of such tools may lead investors to overestimate transition and lock-in risks and pursue a strategy of divestment rather than investing in the industry's low-carbon transition. For example, investors may be more willing to finance a high-emitting company if a federally endorsed taxonomy sets achievable emissions-intensity thresholds that allow the firm to qualify for a "transition" label for the foreseeable future.

## **Co-ordinate and ensure interoperability**

Canadian climate reporting disclosures requirements should be interoperable with other jurisdictions. Canada should align its disclosure frameworks with existing international regulations and standards to ensure a unified approach. The Canadian Sustainability Standards Board CSDS 1 and CSDS 2 have been developed to align with international standards developed by the International Sustainability Standards Board for this purpose.

A co-ordinated, consistent regime will reduce confusion, duplication, and cost. In the absence of a common baseline, voluntary disclosers are often inundated with overlapping requests from lenders, investors, rating agencies, and customers, many of which ask for similar information in slightly different formats. Because non-response or partial response can be interpreted as a red flag, firms are effectively compelled to expand internal reporting capacity to meet these demands.

## **Manage litigation risks**

Canadian businesses leaders, particularly in the energy sector, are concerned about the litigation risk related to disclosures. This can be managed through the use of safe harbours, where companies can disclose information in good faith as long as they follow established policies and act transparently. This would encourage companies to make more open disclosures without fear of being sued for minor errors or good-faith estimates.

"Comply or explain" is another regulatory approach where firms either comply with specified governance or disclosure provisions, or publicly explain and justify any departures, allowing investors and the market to assess and discipline non-compliance.

While these features can be helpful as firms grapple with the new disclosure regime, they should not be a permanent fixture. Leniency measures such as those listed above can be gradually removed. Regulators should eventually require full compliance.

## CONCLUDING THOUGHTS

Mandatory sustainability disclosure entails real risks and trade-offs. Compliance costs can be uneven, and poorly calibrated requirements can encourage boilerplate reporting.<sup>8</sup> However, the evidence reviewed in this paper suggests that when sustainability disclosures are credible and comparable, they can improve the information environment, yielding benefits for the overall resilience of markets and shifting incentives to prioritize climate-risk management.

The policy challenge for Canada is therefore not whether to mandate disclosure, but how to design a regime that delivers material, comparable information while limiting unnecessary burdens to firms. Although this paper has focused on capital market effects, it is also important to emphasize the regulatory benefits in the Canadian context. Guideline B-15 by the Office of the Superintendent of Financial Institutions (OSFI) requires Federally Regulated Financial Institutions (FRFIs) to manage and report on climate-related risks, yet clients of financial institutions are not subject to the same reporting standards. This disconnect reduces the quality of risk assessments and raises compliance costs, as FRFIs must rely on third-party estimates or engagement to obtain missing data. The resulting uncertainty then flows into supervisory reporting, weakening OSFI's ability to monitor and manage climate-related risks across the financial system.

A well-designed mandatory disclosure regime would support both more efficient capital allocation and more effective prudential oversight. It would also complement other climate-risk policy tools, such as taxonomies and greenwashing regulation, by providing a more reliable information base for evaluating claims and tracking progress. By learning from global experiences, Canada can craft a disclosure regime that mitigates the risks associated with past disclosure regulations while achieving the benefits of more transparent climate-related risks, and more efficient capital markets.

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<sup>8</sup> Boilerplate disclosure in this instance refers to the possibility that additional disclosure requirements improve the quantity but not the quality of information, resulting in costs that outweigh the benefits.

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