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DO INSIDERS COMPLY WITH DISCLOSURE RULES? EVIDENCE FROM CANADA, 1996-2011

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SUMMARY

The disclosure of information on the granting of stock options as part of senior managers' compensation packages can be a cumbersome and patchy process in terms of both regulatory compliance and public accessibility. Closing the gaps to make the reporting and accessing of data less unwieldy and more timely, efficient and accurate, should be a priority for securities regulators

Firms are required to disclose the issuing of stock options to their highest-level executives in their annual information circulars. Slight additions made to the information provided in the circulars, such as stock option grant dates, would greatly improve corporate transparency. Insiders also need to be educated on their duty to file, as they bear a fair amount of the responsibility for the problems in the system.

Insiders' lack of awareness about compliance contributes to discrepancies between insider disclosure and company disclosure, and creates information gaps. Misfiling, failure to file, and late filing of data — which can be a chronic problem — further hamper the disclosure process. Add to this the issue of limited accessibility created by a frustrating lack of linkage between databases and a paucity of online searchability capacity.

This paper's research shows that compliance levels are quite high in regards to reporting of information in proxy circulars. However, 12 per cent of stock option awards are not made public outside of the circulars, with 10 per cent of awards to CEOs, nine per cent to CFOs and 15 per cent to VPs going unfiled. The incidence of unfiled reports also includes 22 per cent of insiders for whom stock options are the only award. Equally worrisome is the fact that 26 per cent of insiders have at least one option award that goes unreported and nearly eight per cent of insiders never file. Some 34 per cent of insider awards are filed with information that differs from the data reported in the

firm's information circular. Confusion and procedural ignorance about compliance on the part of insiders contribute to such discrepancies.

The System for Electronic Document Analysis and Retrieval (SEDAR), the continuous disclosure database that firms use, cries out for modernization. Not only does its archaic reporting system limit its accessibility, but it functions separately from the database insiders use, the System for Electronic Disclosure by Insiders (SEDI). Linking the two databases would streamline insider filing requirements, increase compliance with insider disclosure, and improve the audit and compliance function of the securities regulators.

The financial penalties for non-compliance or irregularities should be an incentive for both insiders and issuers to educate themselves and ensure they are meticulous in producing error-free, timely data and in making those data public. Unfortunately, enforcement is inconsistent. Currently, penalties tend to be applied only if another serious regulatory breach accompanies the misfilings, late filings or chronic non-filings.

Canada's disclosure system needs fixing and streamlining in order to achieve the highest level of transparency on executive compensation. Some of these fixes are simple, others may be costly, but if improvements are not made, the system's integrity, along with shareholder and public confidence, risk being seriously compromised.

I. INTRODUCTION

Securities regulators have long been concerned with insider trading. Insider trading occurs when individuals with access to confidential information about a company exploit that information for financial gain. That financial gain typically comes through the acquisition or disposition of various securities related to the company, including through the trading of the company's stock or through the possession of rights to acquire that stock (e.g., stock options). It is commonly held that such insider trading erodes public confidence in financial markets and investors' expectations of profit, which raises the cost or impedes the availability of new capital and ultimately hinders new economic activity and growth.[1]

In order to protect investors and restore market efficiency, securities regulators need to combat insider trading. There are typically two regulatory responses to curb insider trading: criminal sanctions and insider disclosure. Criminal sanctions work by increasing the costs associated with being caught engaging in insider trading, whereas insider disclosure works by communicating obligations and increasing the probability that someone engaging in insider trading will be caught.

What are disclosure rules? Disclosure rules require corporate executives and other individuals with potential access to non-public information to file public reports concerning securities held in their company (known as insider disclosure). The idea behind these rules is that an individual who knows that the details associated with their acquisitions and dispositions of securities are publicly available and subject to scrutiny will be less likely to engage in insider trading. Of course, disclosure rules will only be effective if insiders actually comply with them, yet little is known about insider disclosure compliance in Canada.[2]

One of the difficulties in investigating compliance is selecting a methodology and then obtaining access to appropriate information that will allow you to determine if the rules are being followed. One popular method of exploring compliance is to use third-party reporting and data matching, as is often used in the field of tax compliance. The method simply requires that the third-party provided information be accurate and contain much

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[1] There is also some debate as to whether insider trading laws achieve these objectives. The seminal work in this area would be H. G. Manne, 1966, *Insider Trading and the Stock Market*, (New York: The Free Press). Manne essentially argued that not only does insider trading do no harm, but it also provides a social benefit. In addition, A. Bris, "Do Insider Trading Laws Work?" *European Financial Management* 11(3), 2005, 267-312, shows that prohibiting insider trading makes it even more profitable; and U. Bhattacharya and H. Daouk, "When No Law is Better than Good Law," *Review of Finance* 13(4), 2009, 577-627, demonstrate that no securities law is better than a case where the securities law is not enforced.

[2] W. McNally and B. Smith, "The Effect of Transparency on Insider Trading Disclosure," *Canadian Public Policy* 36(3), 2010, 345-58, and M. Chang and Y. Lim,"Late Disclosure of Insider Trades: Who Does it and Why?" *Journal of Business Ethics* 133, 2016, 519-531, have investigated some of these questions by examining the accuracy and timeliness of insider disclosure of equity trades in Canada and Australia respectively. For Canada, McNally and Smith imputed reporting errors based on observing daily share information and found that errors have tapered in recent years and disclosure has become timelier. They still recommend a system for real-time disclosure and that fines for misleading and late disclosure be imposed. For Australia, Chang and Lim compared trading information reported by insiders to the Australian Securities Exchange to that reported in the insider's firm's annual report. They find that about six per cent of insider reports contained discrepancies which they interpreted as meaning that the insiders were late in filing their trade reports. They recommend improved governance measures to address this so-called late filing behaviour. The Ontario Securities Commission, OSC Staff Notice 51-726: Report on Staff's Review of Insider Reporting and User Guides for Insiders and Issuers, 2016, (available at http://www.osc.gov.on.ca/documents/en/Securities-Category5/sn_20160218_51-726_review-insider-reporting.pdf) also recently completed an investigation into compliance with disclosure rules that employs a similar methodology detailed in this paper. The OSC found that 15 per cent of insider reports contained material deficiencies; the report recommends educating issuers and reporting insiders about their disclosure requirements.

of the same information available in the matched data. A key advantage of using third-party reporting is that it broadens the types of questions that can be answered, particularly determining the extent and intensity of compliance, and allows for an increased ability to contextualize probable causes of errors and omissions. A disadvantage is that third-party reporting of information is often not available.

In Canada, third-party reporting of insider trading does not exist for most securities, but is available for stock option awards to select insiders at Canadian publicly traded companies. The third-party reporting for stock options happens as a result of continuous disclosure rules. Continuous disclosure rules require that publicly traded companies provide a detailed breakdown of certain insiders' compensation, including stock option awards, in their annual detailed information circular. These circulars are required to be made publicly available and the information provided in them is highly accurate for several reasons. First, information circulars are provided to shareholders in advance of annual or other shareholder meetings and contain the necessary data to inform shareholder votes, including "say on pay" votes. To provide misleading information in proxy circulars would subject the corporation to lawsuits based on solicitation of proxies through false or misleading statements. Second, information circulars are also prepared by the corporation which has full access to detailed records related to executive compensation and stock option awards including the dates on which the grants of options were approved. Third, these filings are subject to regulatory scrutiny including random audits by securities regulators and the consequence of disclosure irregularities can be material.

Not only is there the opportunity to investigate compliance with disclosure rules using stock option awards, but there is also policy interest in the timely and accurate disclosure of these compensation instruments. One hundred per cent of Canada's largest public corporations granted stock options to their executives (Klassen 2002, 41) and stock options have also become the single largest component of compensation among chief executive officers (CEOs) at large publicly traded companies in Canada. In addition, the existing stockpile of stock option awards among Canadian insiders is substantial. According to Mackenzie (2012, p. 8) the top 100 Canadian CEOs: (1) were the recipients of stock option awards which value averaged \$3.22 million; (2) held unvested stock options valuing \$549 million (a per capita amount of \$5.29 million); and (3) held vested stock options valued at \$2.0 billion. Finally, there are concerns about stock option granting practices, including (1) "spring loading" or issuing grants immediately before the release of "good news"; (2) "bullet dodging" or issuing grants immediately following the release of "bad news"; and (3) "backdating" or the act of choosing a date for a stock option grant after that date has occurred but claiming to have granted the options at that earlier date in order to take advantage of the historical price performance of a company's stock. Since the Canadian Securities Administrators have clearly noted that disclosure requirements for stock option grants limit these improper dating practices (*Insider Reporting Requirements and Exemptions,* Companion Policy 55-104CP [CP 55-104], s. 1.3(2)), studying actual compliance with these requirements is important to understanding their deterrence efficacy.[3]

[3] S. B. Avci, C. A. Schinpani, and H. N. Seyhun, "Ending Executive Manipulations of Incentive Compensation," *Journal of Corporation Law* (forthcoming 2016) provide evidence that executives continue to employ these manipulative dating practices.

To investigate compliance with insider disclosure rules in Canada, I exploit this availability of third-party reported information. I collect information on stock option awards from a sample of Canadian public companies' annual information circulars for the period 1996-2011. I then compare this information to that reported by the individual insiders in their disclosure reports. The resulting data allow me to investigate the following questions: Do insiders file their insider reports? Are their filings timely? Are their insider reports accurate? Have recent changes to reporting requirements made any difference in compliance rates? Overall, I find that while the majority of insiders properly and accurately file their disclosure reports, a concerning minority fail to file, file after the required reporting period, or file inaccurate information. I consider the consequences of this finding and suggest ways to improve the quality of insider reporting in Canada.

The remainder of this paper proceeds as follows: Section II provides a brief history of insider reporting; Section III outlines the current insider and continuous reporting system; Section IV discusses data collection and matching process; Section V reports on and discusses the results of the data analysis; Section VI offers recommendations for future improvements to reporting mechanisms, and Section VII concludes the paper.

II. A BRIEF HISTORY OF INSIDER REPORTING IN CANADA

Disclosure rules were first embodied in securities regulation in the U.S. as a direct result of the stock market crash of 1929. Canada, however, did not adopt disclosure rules until 1966, principally after two events.

The first event was Shell Oil's 1962 offer to acquire shares of Canadian Oil Companies, Limited, which included concerns that insiders with prior knowledge of the deal had traded on that information and made significant profits. (Armstrong 2001, 224) At the time, however, there was nothing illegal about distributing insider information or acting on this information. (Armstrong 2001, 223-224) Nonetheless, the Shell Oil case garnered plenty of attention,[4] including a lame duck inquiry that uncovered ample evidence of suspicious behaviour but with no ability to take any action (Armstrong 2001, 224-225). The Shell Oil case and the resulting inquiry led in part to the 1963 formation of the Attorney General's Committee on Securities Legislation (hereinafter "the Kimber Committee") whose primary concern was to consider the problem of insider trading and the degree of disclosure (Ontario 1965, 6) and make recommendations for changes to securities regulations.

The second event was the Texas Gulf Sulphur (TGS) scandal (also known as the Windfall scandal) that erupted in 1964 (Davies 1975, 218-220), which had a direct influence on the recommendations made by the Kimber Committee in 1965 (Ontario 1965). The details of the TGS case were aptly summarized by Fleischer (1965) as follows:

> The company made an extraordinary mineral discovery in 1964 on its Canadian property at Timmins, Ontario. Before information about the development was released to the public, several officials of the company purchased shares of its stock on the open

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[4] As Armstrong (C. Armstrong, *Moose pastures and mergers: The Ontario Securities Commission and the regulation of share markets in Canada, 1940-1980* (Toronto: University of Toronto Press, 2001), 224) notes "partly on the nationalistic grounds that the only integrated oil company under Canadian control was being taken over by a multi-national and partly on account of growing concerns about corporate concentration as a result of such mergers."

market and one also advised his friends or associates to acquire the stock. Furthermore, the board of directors, without knowledge of the importance of the new discovery, issued stock options (exercisable at the then-current market price of the stock) to certain key management officials, who were aware of the Timmins find. Subsequently, the company issued a press released discounting as unfounded rumours that there had been a significant ore strike. Several days later, news confirming the extent and significance of the strike was released to the public and the price of the Texas Gulf Sulphur stock increased substantially. Before the end of the press conference at which this news was made public, certain directors instructed their brokers to purchase the company's stock … (1273)

The Kimber Committee acknowledged that both market efficiency and ethical trading are necessary requirements for effective financial markets (Ontario 1965, 10). With the Shell and TGS cases fresh in their minds, the Kimber Committee recommended a system for both insider and continuous disclosure intended to restore investor and public confidence in the securities industry.

Insider disclosure (ID) placed a reporting requirement on an issuer's insiders when they acquire ownership or trade in the issuer's securities. ID was seen as an effective way to address the problem of insider trading because "the insider who knows that his trading will become public knowledge will be less likely to engage in improper trading" (Ontario 1965, 10).

CD included requirements for both periodic disclosure (e.g., annual financial statement) and timely disclosure (e.g., material change reports). One required periodic disclosure report is an annual detailed proxy information circular. As noted by the Kimber Committee, "in these days of large public companies with numerous shareholders, who as a rule do not have a voice in management of the company, the proxy assumes major significance in the control of companies" (Ontario 1965, 49). The committee stated that periodically sharing knowledge with investors who would otherwise not be privy to the corporate management increases investor confidence directly and economic growth indirectly.

These two disclosure recommendations were first introduced in Ontario in 1966 and later introduced in all remaining provinces.[5] Since their introduction, disclosure rules have been periodically revised to make them more effective and timely and to respond to events or technological advances in the market.[6]

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5 Until 2001, the Canada Business Corporations Act (R.S.C., 1985, c. C-44, s.127) included reporting requirements for insiders. Such a requirement was consistent with requirements in the U.S. at the time and historically with other Canadian provinces. In 2001, Bill S-11 (an Act to Amend the Canada Business Corporations Act and the Canada Cooperatives Act and to Amend Other Acts, 37th Parliament, 1st Session, 2001) made sweeping changes to the Act, including to insider reporting rules. According to the government of Canada, this change was made to avoid unnecessary duplicate filing; insiders would still be required to comply with the reporting requirements of provincial legislation.

6 There have been a number of calls for a national securities regulator as opposed to the series of provincial regulators that currently exists. The origin for these calls dates back to 1979 when there was an extensive review of Canadian securities legislation which culminated with the publication of *Proposals for a Securities Market Law for Canada*. For a comprehensive explanation of the background of this ambitious but ultimately ill-fated early proposal for a national securities regulator for Canada, see Philip Anisman, "The Proposals for a Securities Market Law for Canada: Purpose and Process," 19 Osgoode Hall L.J. 1981, 329.

III. RULES REGARDING THE DISCLOSURE OF STOCK OPTION AWARDS

This section summarizes the disclosure requirements over the period of interest, namely 1996-2011. It provides answers to the following question: who is required to file disclosure reports, what information needs to be included in these reports, when the reports have to be filed, how the reports are filed, to whom the reports are filed, and what the reporting penalties are. The requirements for insiders are described first, followed by the disclosure requirements in the issuer's information circular.

Disclosure by Insiders

Compton et al. (2011) provide a recent and detailed account of the insider disclosure regulations and requirements in Canada, which I will summarize here as they currently apply to the reporting of compensatory stock option awards.

Who must report? The term "reporting insider" was introduced in *Insider Reporting Requirements and Exemptions*, NI 55-104, s. 1.1(1) (23 April 2010) [NI 55-104] and details who is required to file insider reports.[7] A reporting insider generally includes the CEO, CFO, COO, director, or a person responsible for a principal unit of a reporting issuer. The insider, however, may designate an agent who can "file information on behalf of insiders" (CSA 2008, 93).

When must they report? These reporting insiders are required to publicly disclose option awards within a certain period of time from the grant date, called the filing deadline. The filing deadline has changed three times since 1996. Until Dec. 13, 1999, insiders were required to disclose options awards within 10 calendar days of the end of the month in which the options were granted. For example, if an award was made on March 8, 1997, the insider was required to submit a report of that award by April 10, 1997. From Dec. 14, 1999 to Oct. 31, 2010, the insider report had to be filed within 10 calendar days of the grant date. Since Nov. 1, 2010, the reporting period has been five calendar days.[8]

What must they report? As set out in NI 55-104, s. 1.4(6) insiders must report the details related to all financial instruments, including all stock-based compensation instruments. With respect to stock options, which are included in these reporting requirements, the insider must provide the security designation, which in the case of typical employee stock option awards is "Options", and the nature of the transaction, which is "Grant of Options." The insider must also provide the date of the transaction, which for stock option awards is the date when "the legal steps necessary to authorize the issue of the options have been completed" (Torys 2006, 2) (hereinafter the "grant date"). The number of options acquired

[7] Although the insider reporting obligations set out in NI 55-104, s.9.2 do not apply in Ontario, this definition of reporting insider also governs the insider reporting obligations of the Ontario Securities Act (R.S.O. 1990, c. S.5, s. 107.

[8] This still puts Canada at a longer filing window than that in the U.S. where stock option awards must be filed by insiders within two business days.

must be provided, along with the exercise price,[9] the currency at which they were awarded, and the options' expiration date.[10]

How must they report? Since June 9, 2003, all insiders must file their reports on the System for the Electronic Disclosure by Insiders (SEDI), which is a public web-based system for "the transmission, receipt, review and dissemination of insider reports and related information" (*System for the Electronic Disclosure by Insiders (SEDI),* NI 55-102, s, 1.1 (June 13, 2008) [NI 55-102]). Under SEDI, as soon as the insider files their report, the report is publicly available.

SEDI replaced an antiquated paper-based reporting system. Under this system, the insider filled out a paper-based form and sent (mailed or faxed) the form to the appropriate securities commission. The securities commission passed these forms on to a third party (e.g., the OSC used Micromedia) for data input, which was then transmitted back to the appropriate securities commission who then eventually published the information in a publicly available periodic securities bulletin; for the OSC, insider reports were published in its weekly securities bulletin (OSCB). Under the old paper-based system, the public had to wait until the reports were published. In addition, the OSCB did not report expiration dates.

In theory, the move to the SEDI web-based disclosure system should better contribute to achieving the goals of insider disclosure (market efficiency and ethical trading) assuming, of course, that the information filed is timely, complete and accurate. Investors have access to insider reports as soon as they are filed, which may lead to better knowledge and greater investor confidence. SEDI's accessibility may also encourage ethical behaviour by making it easier for investors and other members of the public to view the insiders' actions. The increased visibility of insider activities may discourage insiders from engaging in questionable practices.

To whom must they report? With the advent of SEDI in 2003, insiders need only file their reports on this system. Prior to SEDI, reporting insiders were required to report to the securities commission in every jurisdiction where the security issuer was a reporting issuer. This meant that every reporting insider at an issuer who is listed on the Toronto Stock Exchange (TSX and TSX-Venture Exchange) must, at a minimum, file insider reports to the OSC. Obviously, SEDI has eased the complication of filings in multiple provincial jurisdictions.

What are the reporting penalties? The Ontario Securities Act was recently amended to include s. 76(3.1) which prohibits a person who possesses undisclosed material information from recommending trades or encouraging others to trade in securities of the issuer. While there are no specific penalties for filing erroneous or misleading reports, all of the provinces do have general provisions that make it an offence, punishable by fine or imprisonment, to break securities laws. For example, paragraph 122(1)(c) of Ontario's *Securities Act* (RSO 1990, c. S.5, s. 122(1)(c)) provides: "Every person … that contravenes Ontario securities law is guilty of an offence and on conviction is liable to a fine of not more than $5,000,000

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9 Under the SEDI system, there are two places where the options exercise price may be reported: the "unit price of exercise price" column or the "conversion or exercise price" column. When collecting the data, I am careful to examine both columns, and entries in either column are recorded.

10 Insiders must also provide their closing balances. For insider reports filed on the SEDI, the closing balance is automatically provided. Obviously, if a report is not filed or misfiled, which affects this balance, the balances reported on SEDI will be incorrect.

or to imprisonment for a term of not more than five years less a day, or to both." Provincial securities commissions also have the power to order administrative penalties, the maximum of which is usually between $1 million and $5 million. However, in practice, these laws have not been applied to improper insider reporting. Indeed, I am not aware of any case where an individual was charged with producing misleading insider reports.

Only a handful of provinces have penalties for late filing (CSA, n.d.a.). In British Columbia (B.C. Reg. 196/97, 1997), Manitoba (Man. Reg. 491/88R, 1998) and Ontario (*Fees*, O.S.C. Rule 13-502, (2 April 2010), s. 4.3(3)), the penalty for late filing is a relatively modest fine of $50 per day, and in Manitoba and Ontario this fine is capped at a maximum of $1,000 per firm (in which the individual is an insider) per year. Quebec (OC 660-83, 1983) levies a fine of $100 per day up to a maximum of $5,000. In addition, Alberta (since March 30, 2004) and Quebec (since Feb. 17, 2003) publicize the names of late filers online. Compton et al. (2011, 484-487) discuss the efficacy of late filing penalties in Canada, noting that "the extent to which these penalties deter late filing is uncertain" (485). It is also important to note that additional enforcement actions against late filers have only come about as part of other more serious breaches of securities law (e.g., Hinke, Re, 2006 Carswell Ont. 3023, 29 O.S.C.B. 4171).

Disclosure by Issuers (Continuous Disclosure)

This section details the third-party reported information that occurs through the continuous disclosure requirements on issuers. This is the information that will be collected and matched to the insider disclosure to determine the level of insider compliance with disclosure rules.

Who must report? In general, a reporting issuer must publish an annual detailed information circular to its shareholders. A "reporting issuer" is a corporation that has issued securities under a prospectus or has its securities listed on a regulated stock exchange, such as the Toronto Stock Exchange.

When must they report? The annual information circular is prepared in advance of annual shareholder meetings that are held after the end of the issuer's financial year.

What must they report? In the 1980s and 1990s, most jurisdictions in Canada added rules for the inclusion of information on executive compensation in the annual information circular. Initially, reporting issuers were required to provide compensation information on the five highest paid officers in the aggregate. In 1993, Ontario required reporting issuers to include a breakdown of that compensation, following similar changes in the U.S. (Johnston and Rockwell 2006, p. 98).

Detailed reporting of executive compensation subsequently spread to all the provinces and is currently encompassed in NI 51-102F6 (See NI 55-102). NI 51-102F6 covers only a handful of officers referred to as Named Executive Officers (NEOs), which are the CEO, CFO, and three other most highly compensated officers provided that their individual total compensation exceeds $150,000. If an individual becomes a NEO part way through the reporting year, the issuer must still report the compensation for that individual for the entire reporting year.

Issuers are expected to provide details of all options granted to NEOs in the reporting year and to disclose these specifics in a prescribed format. Since 2008, the required reporting format, with some degree of latitude, is show in Figure 1 below. The number of securities, exercise price, expiry date, and the value of options at the time of the award must be reported. Some companies also report the date on which the options were granted and the market price of the stock on the date the options were granted, but this information is not required.[11] If the amounts provided in the table are not in Canadian dollars, then the issuer must disclose the currency used. If the amounts provided are converted into Canadian dollars, the issuer must disclose the currency exchange rate and the methodology used to convert the compensation.

FIGURE 1 STOCK OPTION COMPENSATION TABLE FORMAT REQUIREMENT

	Option-based Awards				Share-based Awards		
Name (a)	**Number of securities underlying unexercised options (#)** (b)	**Option exercise price ($)** (c)	**Option expiration date** (d)	**Value of unexercised in-the-money options ($)** (e)	**Number of shares or units of shares that have not vested (#)** (f)	**Market or payout value of share-based awards that have not vested ($)** (g)	**Market or payout value of vested share-based awards not paid out or distributed ($)** (h)
CEO							
CFO							
A							
B							
C							

Source: Form 51-102F6, page 12

An important point to note is that the reporting requirement, as alluded to in the heading to column b in the figure, is actually related to the number of outstanding option awards for the reporting year. That is, only the number of securities related to unexercised options need to be reported. This means that if a NEO receives a stock option award in a reporting year and all or a portion of the options vests and the insider chooses to exercise the vested options in the reporting year, then the number of securities reported in the annual proxy will be the total award minus the exercised options. This is a curious practice as it means that the annual proxy may not accurately reflect the total compensation for NEOs if a stock option award in a reporting year also vests and the insider elects to exercise the vested options. While the typical practice is for options not to begin to vest until a year after an award is made, there is no requirement for this and there are examples of stock option plans and awards in my sample that do not place such a vesting limit on the option awards. This is an important complexity that will have to be kept in mind during the data matching process.

Each company must also provide the objectives of the compensation program. In the case of stock options, this usually means outlining long-term goals like performance-enhancing

11 It is interesting that issuers are not required to report the grant date of the option award, given that it represents the date that the executive received compensation. While the expiration date along with the information in the stock option plan can be used in most cases to back up the grant date, the grant date seems to be pertinent information related to the executive compensation that is being reported in the annual proxy report.

incentives and employee retention. Companies must also disclose information related to stock options, specifically "the process the company uses to grant options to executive officers including the role of the compensation committee and executive officers in setting or amending any option program. State whether previous grants of options are taken into account when considering new grants" (NI 51-102, Appendix B, para. 2.3). The process used to grant options is usually disclosed by outlining the specifics of an option plan. This includes the term of options, the way in which price is determined, and the schedule at which options vest and expire. This information will be important for verifying or imputing the stock option award grant date.

How and to whom must they report? Since Jan. 1, 1997, all reporting issuers have been required to file their CD documents, including the annual information circular, on the System for the Electronic Document Analysis and Retrieval (SEDAR). SEDAR's purpose was to create a public electronic forum where companies could file required reports without filing paper documents in multiple jurisdictions. As per the SEDAR Filer Manual (CSA 2010, 53-54), prior to September 1999 issuers were allowed to submit their documents in Word, WordPerfect or PDF formats. Since then, only PDF documents are allowed. In addition to posting the report on SEDAR, the information circular must also be provided to all shareholders.

What are the reporting penalties? To provide misleading information in proxy circulars would subject the corporation to lawsuits based on solicitation of proxies through false or misleading statements. These filings are subject to regulatory scrutiny, including random audits by securities regulators, and the consequence of disclosure irregularities can be material.

Summary

Table 1 summarizes the information that is reported for stock option awards through disclosure requirements and whether the information is required or optional. Column A details the information that must be provided in insider reports and column B matches that to what is provided in the third-party information circular reports. The only piece of information that is not consistent across the two sources of information is the grant date which does not need to be provided in the annual information circular. However, some issuers do voluntarily provide that information or it can be imputed from the additional detail provided in the information circular regarding the stock option granting practices followed by the issuer.

TABLE 1 INFORMATION PROVIDED IN THE INSIDER REPORTS AND ANNUAL INFORMATION CIRCULAR

	Insider Reports A		Issuer's Annual Information Circular B
Source	Weekly OSCB	SEDI	SEDAR
Insider/NEO Name	Required	Required	Required
Type of Security Awarded	Required	Required	Required
Award or Grant Date	Required	Required	Optional
Number of Securities Awarded	Required	Required	Required
Exercise Price	Required	Required	Required
Expiration Date	No	Required	Required
Currency	Required	Required	Required
Disclosure Date	Publication Date	Filing Date	No

The table shows that the inclusion of stock option award information in both ID and CD requirements provides an opportunity to assess the accuracy of insider trading reports through the use of third-party reporting and data matching. The approach and the data available will allow me to determine compliance with reporting rules, particularly the extent and intensity of failing to file the required insider reports. I can also determine whether the information provided by insiders through ID is accurate, what specific information is inaccurate, and what actions might redress these inaccuracies in the future.

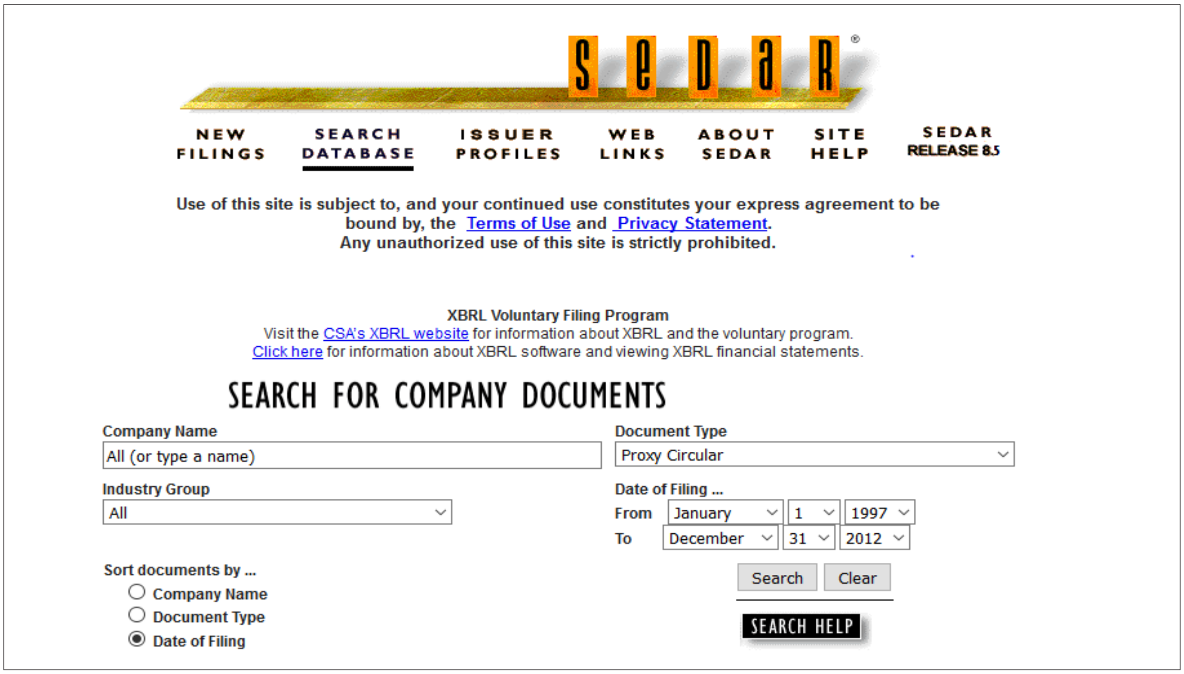
IV. DATA COLLECTION AND MATCHING

The data collection process is carried out through three steps. First, the information on stock option awards from the annual information circulars is collected. Second, I use the additional information the issuer provided to verify the reported information. Third, I use a sample of obtained stock option awards to search for and obtain the matching information from the insider reports.

Step 1: Information on Stock Option Awards Contained in the Issuer's Annual Information Circular

To keep the data collection and matching to a reasonable scale, I began by defining a sample of issuers. I originally defined a sample of 121 companies that were trading on the TSX as of Dec. 31, 2010. I then accessed any information circulars filed for the companies from the inception of SEDAR through to 2012, searching by company name. Because proxy circulars report on information over the preceding reporting year, this means I obtained information on stock option grants from 1996 to 2011. The SEDAR search interface is shown in Figure 2 below.

FIGURE 2 SEDAR SEARCH INTERFACE



Source: Screen capture image from http://sedar.com/search/search_form_pc_en.htm

SEDAR includes a feature that links companies that have merged or changed names. This allowed me to expand the sample to include previous incarnates, parents, or companies absorbed by the company included in the original list. That is, if a company on the original list was created from one or more previous companies, the previous companies were added to the original list and I collected compensation data on them as Ill. Through this process, an additional 52 companies were added to the list for a total of 172 companies.

I downloaded all the available proxy circulars for each company and reviewed each document for the required information on stock option awards to the NEOs for each company. In order to easily analyze the information, it was carefully transcribed into a database. Of the 172 original companies, 24 companies did not grant options during the sample period.[12] This left a total of 149 companies with stock option grants.[13]

Step 2: Data Verification

It is important for the conclusions that the information reported in the annual information circular is as accurate as possible. This requires me to verify the reported information in a number of ways.

As previously noted, the information circular reports all stock option grants for NEOs for the reporting period, but an individual may not have been a NEO, and hence possibly not an insider, for the whole reporting period. I carefully scrutinize information in the proxy for

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12 I also excluded any option grants award during periods where the company operated as income trusts. I eliminated these periods where a company operated as an income trust as a precautionary measure because, for these entities, it is difficult to distinguish between grants of rights and grants of options. Treating a grant of rights as a grant of options could result in mistakenly interpreting an award as misfiled.

13 Due to the sensitive nature of this research and since the focus of this paper is on insider and not issuer compliance, I do not disclose the companies, sectors or jurisdictions from which the companies were selected.

information related to the date the insider became a NEO. In cases where the information is not clear or not provided, I checked the SEDI system for the date an individual became a reporting insider[14] or scrutinize the OSCB bulletins for any relevant information. Option grants to individuals who were not a reporting insider at the time of a proxy-reported option grant were removed from the sample. This is a necessary step to ensure that an award that is not required to be filed is not erroneously treated as being not filed for disclosure purposes.

As my interest is in insider reporting behaviour, consistently using the same name for an insider throughout the sample is important. However, in the SEDAR reports, how an individual's name is reported can vary across time and across companies. For example, an individual's name can change as their marital status changes or an issuer may list insider names by initials, using just first and last name, or by using the insider's full name. I do a careful review of insider names and use the SEDI system along with Google searches to ensure that I consistently identify the same insider across the sample period.

As detailed previously, the information circular contains additional information that will be helpful in the matching process. I record any information regarding stock splits, currency information, and other related details that could result in information reported in the annual circular report being different from that reported by the insider, and make any necessary adjustments to the reported information.

I also record any relevant information about the stock option plan, including how the exercise price of the option is determined (e.g., closing price of stock traded on the TSX the day before the option was granted) and the expiration period of stock option awards. This information is used in the verification steps that follow.

First, in a number of cases, the company reported a range for the expiration dates (e.g., Aug. 22, 2009-2011) associated with a stock option award, suggesting, but not clearly stating, that the expiration date for the option grant was laddered. A review of the stock option plan determined that the options vested in set tranches and the vest options expired after a set period from the vesting date. Unfortunately, due to the reporting, I am unable to determine what amount of options within the award expired with which date. I record all the relevant information to help with the matching and verification process.

Second, if a NEO leaves a company during a reporting year and after being awarded stock options, the option award will be reported in the annual proxy, but the expiration date attached to those options will likely not be the original one. That is because when a recipient of an option award leaves a company, the option plan usually requires that the options immediately vest and the expiration date reset to a prescribed period following the departure date (e.g., they expire one month after the departure). In these cases, the expiration date reported in the information circular will differ from that reported by the insider. As before, I record all the relevant information to help with the matching and verification process.

Third, because the grant date is not required to be reported in the annual information circular against which the grant date reported by the insider can be checked, it will be

[14] While some insiders accurately report the date they became an insider in the SEDI system, most either have no date reported or the date reported is the date the SEDI system became active. The lack of compliance with this reporting suggests that reporting this information is not policed by any of the Canadian securities regulators.

necessary to use additional information to investigate the accuracy of grant dates which insiders are required to report. As noted above, the annual circular contains information on the reporting period along with information on the issuer's stock option plan, notably the rules used to price the option awards and the rules regarding the expiration of option awards. This information, along with using the issuer's stock data,[15] can be used to attempt to verify grant dates reported by insiders.[16] I test my proposed method of using the information regarding the issuer's stock option plan along with all the information provided for the stock option grants and the issuer's stock data to impute a grant date for those options, where a grant date is reported in the annual information circular, and compare the dates. I am able to confidently impute the grant date reported in the annual proxy for nearly every option award.[17] I then use this method to impute the grant dates for the remaining grants and am able to confidently impute the grant date for most awards.[18]

Information on Stock Option Awards Contained in the Insider Reports

My objective is to compare the information on stock option awards in the proxy circulars to the information provided by insiders through ID and to record any inconsistencies. There are two sources of information for insider reports. Insider reports filed before June 9, 2003 were all paper-based. While these original paper-based filings can be obtained directly from the appropriate securities regulator, they can only be obtained at a significant cost. Instead, the information contained in these insider reports can be obtained from the weekly OSCB. In theory, the data in the bulletins contain all the information provided by the insider in the paper-based report, except that the bulletins omit the date the reports were received by the OSC (i.e., the actual filing date). Consequently, I am unable to investigate compliance with filing deadlines in the OSCB filing regime, but I can still examine the disclosure

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15 I obtained the stock data for each issuer from the Canadian Financial Markets Research Centre (CFMRC) database. The CFMRC includes both listed and de-listed TSX-listed companies.

16 I had hoped that I could simply impute grant dates from the information provided in the annual proxy without using additional information, but I found doing so to be very difficult. There are several reasons for this. First, nearly all option plans set a minimum pricing rule and a maximum expiration rule, meaning that any number of grant dates could fit the stipulated rules. Second, many option plans use complex pricing schemes based on weighted or unweighted averages of the issuer's stock price with some even converted into the USD, which are difficult to definitively replicate. Third, many stock option plans do not provide detailed information about the pricing rules. Notably, the stock option plans simply indicate that the stock option award would be priced at the "market price." However, there is no one unique definition of market price. The market price can be calculated based on the most recent closing price, the closing price on the day before an award, the high or low price of the stock, or the average of a set of price or weighted prices. Hence, simply stating "market price" provides no additional information with which to impute a grant date. Fourth, it became clear that issuers are not consistently following their own rules. For example, issuers who indicated that they used some sort of average of the stock price to calculate an award's exercise price appeared to use the closing price instead for some option grants, assuming the expiration rule was followed. Finally, some stock option awards are made during an active trading day and some are not made until after the markets close on the grant date. In the former case, it usually means the trading day stock data are not used to calculate the stock option award's exercise price, while in the latter, the trading day stock date may be used to calculate the option award's exercise price. Because it is not known from the information provided what the case may be for any given stock option award, it can mean that any imputed grant date could be off by one or more days (in the case of a weekend award) if market prices are similar in this range.

17 It appears in nine cases, which represent two separate awards to all the NEOs, the discrepancy is due to a typo in the proxy report as the imputed grant date accords with the information provided in the stock option plan as Ill as the grant date reported by the insider. In one case, the grant date reported in the proxy was Feb. 14, whereas the imputed date was Feb. 24. In another case, the grant date reported in the proxy was June 24, whereas the imputed date was June 4.

18 Awards where my method will have difficulty in imputing a grant date are those that are priced not-at-the-money, where the exercise price was converted from or to non-Canadian currency, or where the expiration date is set using a rule that is not based on a full calendar year from the grant date (e.g., the option award expires at the end of a calendar year rather than based on the date of the option award).

delay based on the publication date of the OSCB bulletins. In addition, there are many steps where the paper-based insider reports could be lost, data not inputted or transmitted, or a data entry error made. Any finding that suggests the insider filings during the OSCB period were not filed or the data in those filings were incorrect does not necessarily mean that the insider is at fault. It could instead mean that the data published in the OSCB are not accurate.[19]

Insider reports filed on or after June 9, 2003 can be obtained directly from SEDI. In this case, the reports are directly filed by the insider or their designate, so any omissions or inaccuracies are directly attributable to the insider or their designate. Insider reports on SEDI can be accessed through multiple channels which I exploit. I first searched for stock option grant filings by issuer name. If I was unable to locate an insider report by issuer name, which occurred in a number of cases, I then searched by insider name, using a variety of input options. If this did not produce a match, which did occur in some cases, I removed the limit to search only across option grants. By pursuing an exhaustive search process on SEDI, I ensure I do not omit a filing that, for technical reasons, does not appear in more narrowly defined searches. In addition to recording information related to the filing of the option award, I also look to determine if any filings are amended and what information is amended, and also record this information.

As was the case with the issuer reports, in collecting the data from the insider reports I discovered that insiders were not consistent in how they report laddered stock option awards. These are option awards where different tranches of options within an award have different expiration dates. In some cases, insiders report these as one award and either do not report an expiration date or use either their earliest or latest expiration date. In other cases, insiders file a report for each of the tranches. While the latter is the technically correct reporting process, the former leads to finding option awards that were not reported that technically were reported. I err on the side of caution and if a laddered grant is reported as one award, I accept that as a disclosed award.

V. RESULTS

Summary Statistics

The data collection and verification process using the issuer's information circulars yields data on 3,955 option awards to 981 different NEOs employed by 149 companies that were listed on the TSX over the period 1996-2011. Approximately 29 per cent of the awards are to the CEO, 19 per cent to the CFO, and the remaining 51 per cent to VPs and other senior officers. In the majority of the cases (89 per cent), a stock option grant is awarded to more than one NEO at the same time. The most common type of award (55 per cent) is one that is provided to all NEOs.

[19] In an effort to determine the OSCB's degree of accuracy, I obtained copies of the paper filings from the OSC for insider reports for 241 option awards granted by three companies and filed prior to the launch of SEDI. I cross-checked the paper filings against the OSCB and was surprised to find that 38 per cent of the option awards that were duly reported to the OSC by insiders were never published in the OSCB. The missing filings appear to be clustered around specific bulletins, suggesting technical problems rather than a systemic problem.

In terms of the stock option award information that is available in the annual proxy reports, compliance with the reporting requirements is quite high. In all cases, the number of securities associated with the stock option award is reported and the average number of shares granted per option award was 145,852. In all but 11 cases, the exercise price of the option award is reported.[20] With respect to the option awards expiration date, in all but 18 cases the expiration date of the option award is reported.[21] Finally, in terms of voluntarily providing information, 44 per cent of the awards report the market price of the underlying stock on the date the grant is reported,[22] and for nearly 18 per cent of the awards, the option grant date is reported.[23]

Figure 3 displays the distribution of the number of stock awards by year and regime over my sample period. Of the 3,955 awards, 20 per cent were granted before and 80 per cent after the SEDI filing regime was put in place. This distribution is not unexpected given how the sample of companies was defined (companies listed on the TSX listed as of December 2010) and the volatility of companies listed on the TSX at any point of time. The distribution may also be caused by the fact that stock option awards increased in popularity over my sample period.

In the introduction, a number of questions were set out to be explored in this paper and these questions guide the remaining presentation of the results. Do insiders file their insider reports? Are their filings timely? Are their insider reports accurate? Have recent changes to reporting requirements made any difference in compliance rates?

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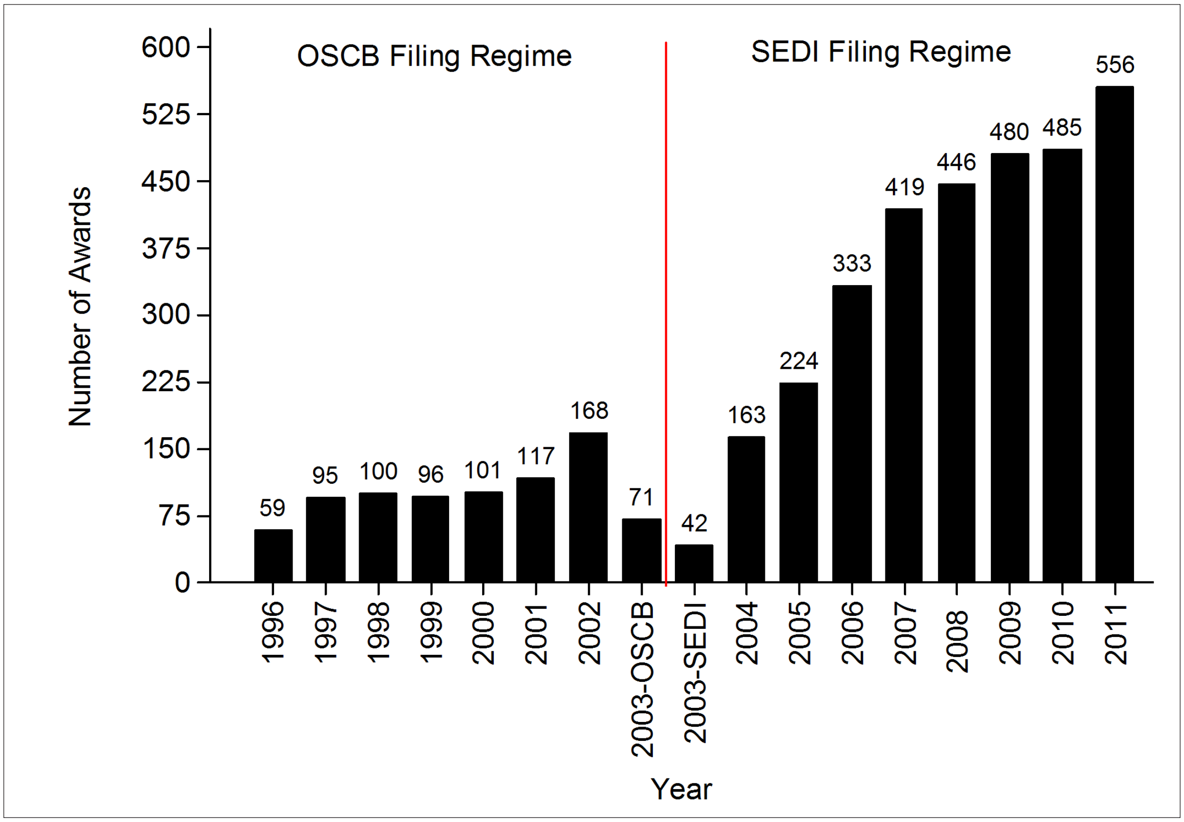
20 Ten of the 11 cases where the exercise price is not reported are for the same company and occur in two consecutive years (2002 and 2003). The company properly reports all information in previous and subsequent years. In the remaining case, the award occurs in the first reporting year of the company, and information is properly reported in subsequent years.

21 11 of the cases correspond to those where the exercise price was also not reported. In the remaining seven cases, the original option expiration date was not reported. Instead, the date reported corresponded to a revised expiration date due to the insider leaving their position with the company, or the company's stock option plan was terminated after a take-over or merger. Because it was not the original expiration date, the date is not recorded in the database.

22 Interestingly, through the process of imputing the grant date, I found that in a number of cases the reported market price does not accord with any plausible definition of the market price of the underlying stock. This is an interesting finding and worthy of follow-up in future work.

23 Nine issuers always report the option grant date and 20 report the grant date for some of their options. This means that 81per cent of issuers never report the option grant date in their annual proxy. Only 9.1 per cent of awards report both the market price and the grant date.

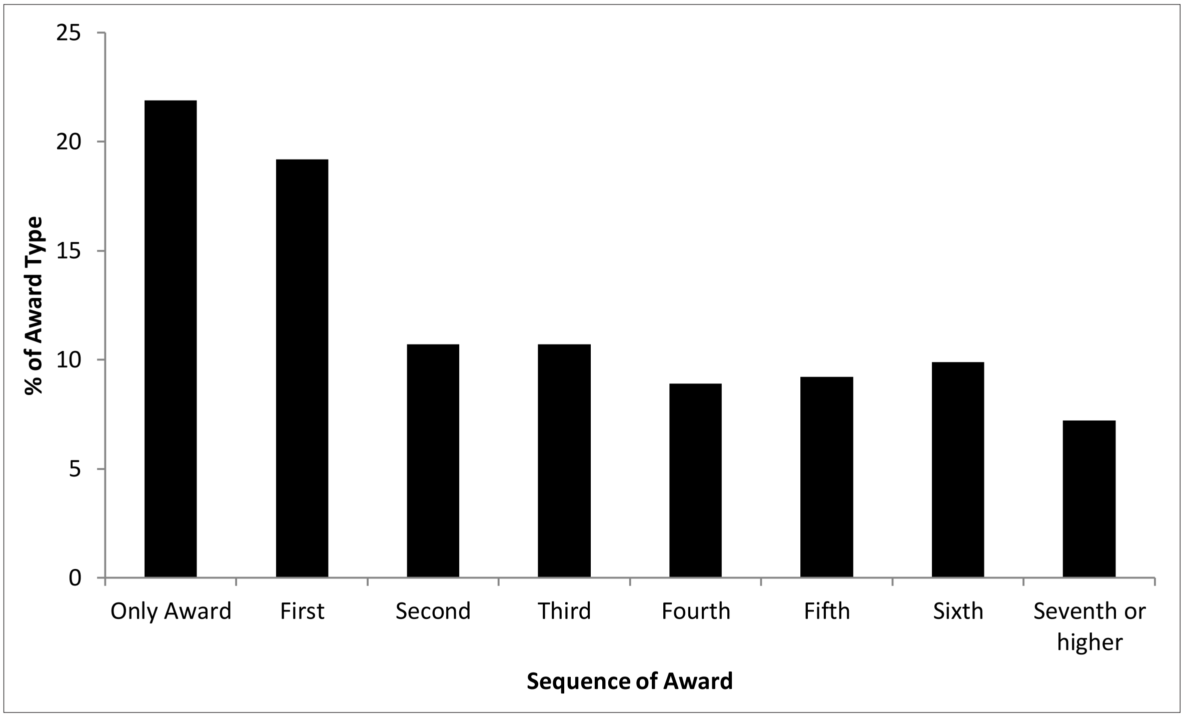
FIGURE 3 DISTRIBUTION OF THE NUMBER OF STOCK OPTION AWARDS BY YEAR, 1996-2001



Do Insiders File the Required Reports?

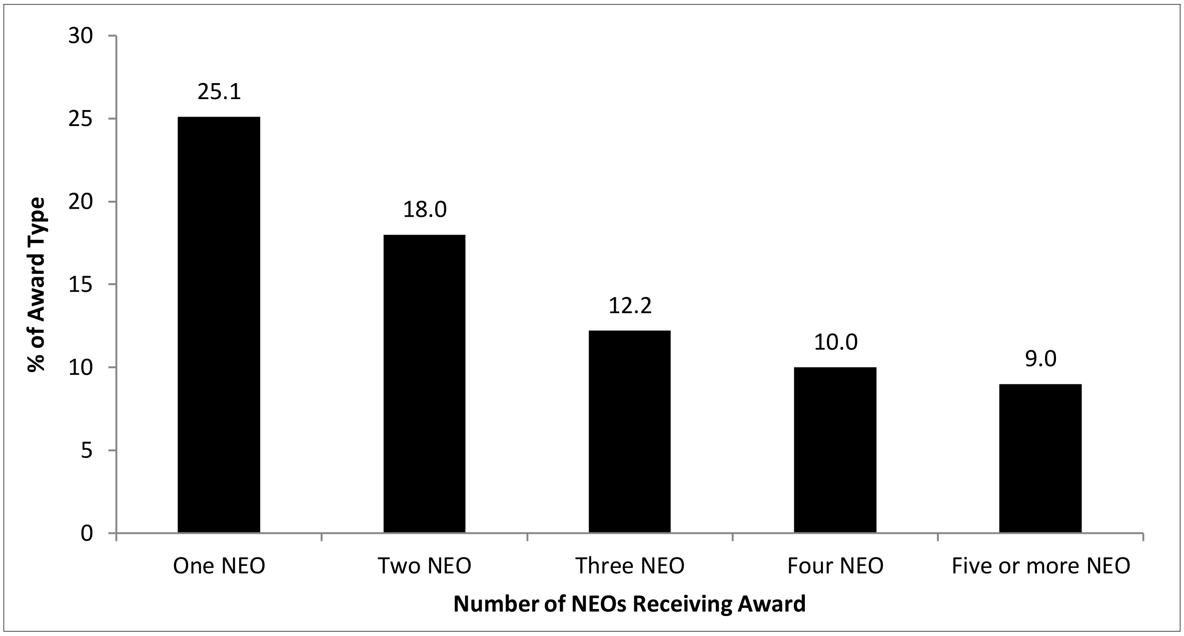
I begin by examining the extent of public disclosure. That is, do insiders file the required reports at all? I find that 12 per cent of awards are not publicly disclosed outside of the issuer's annual information circular. In terms of filing behaviour by position, nearly 10 per cent of stock option awards to CEOs, nine per cent to CFOs, and 15 per cent to VPs go unfiled. In terms of filing behaviour associated with type of award, an insider's only or first award (as it appears in my data set) has a higher incidence of being unfiled at 22 per cent and 19 per cent respectively, compared to around 10 per cent for subsequent, including an insider's final, awards, as shown in Figure 4.

FIGURE 4 PERCENTAGE OF STOCK OPTION AWARDS NOT FILED BY AWARD SEQUENCE



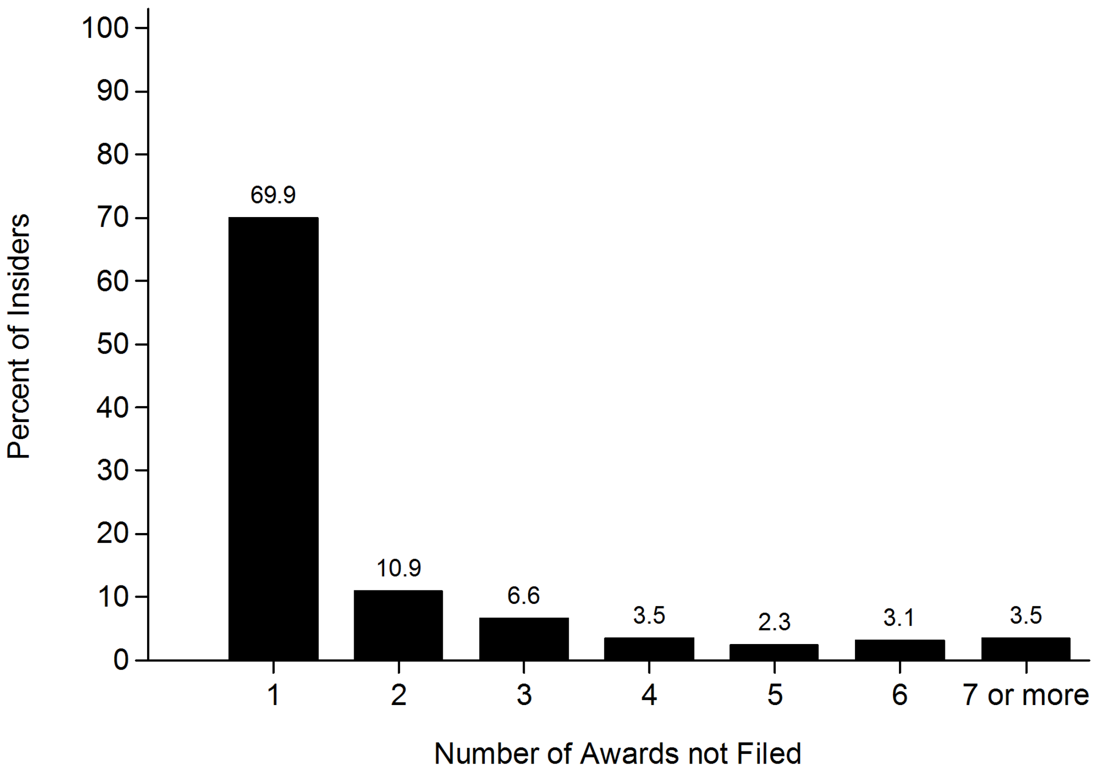
Further, the proportion of awards not filed decreases with the number of NEOs receiving the same stock option award. When only one NEO receives an award, 25 per cent of those awards go unfiled, but that drops to only nine per cent when all the NEOs receive an award, as shown in Figure 5.

FIGURE 5 PERCENTAGE OF STOCK OPTION AWARDS NOT FILED BY NUMBER OF NEOS RECEIVING AWARD



In terms of individuals' filing behaviour, 26 per cent of insiders have at least one option award that goes unreported and nearly eight per cent of insiders never file a single option grant. If I look more closely at insiders' filing behaviour, as shown in Figure 6, I see that most insiders who fail to file mostly only do so once, but that a concerning minority are fairly regular non-filers.

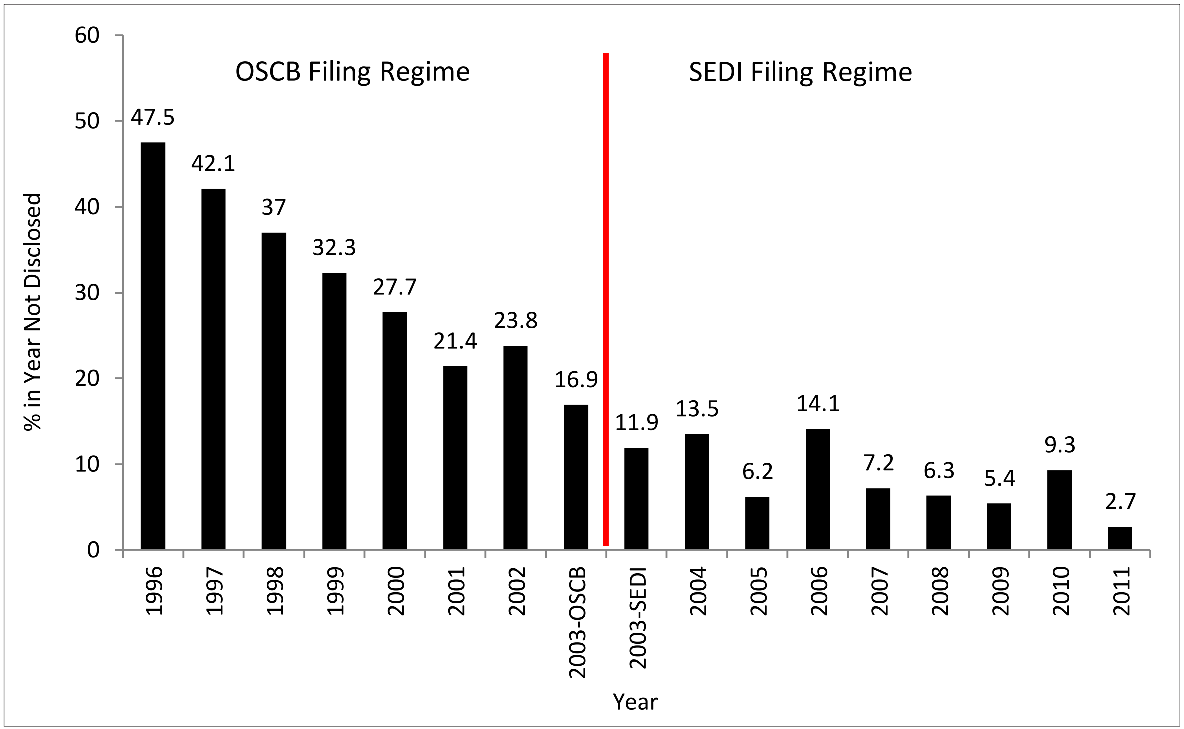
FIGURE 6 DISTRIBUTION OF THE NUMBER OF AWARDS NOT FILED BY INDIVIDUAL INSIDERS



In terms of how non-filing has changed over time, for those stock options granted during the OSCB filing regime, 30 per cent were never published in the OSCB. This means that under the old regime, nearly one-third of insider stock option awards were not publicly disclosed until the publication of the issuer's proxy circular. As a reminder, this result cannot be interpreted as meaning these option grants were never reported to the OSC, given the possibility of publication errors. For those stock options granted during the SEDI filing regime, just over seven per cent of awards were never filed, a remarkable improvement in compliance.

Figure 7 presents the distribution of the frequency of awards not disclosed by year and by reporting regime. The OSCB period is presented to the left and the SEDI period is presented to the right of the vertical line. There are several things to note from the figure. First, Figure 7 shows that public disclosure steadily improved over the OSCB regime, and that trend continued with the implementation of the SEDI filing system. Indeed, the percentage of awards not filed in a given year dropped to six per cent by 2005, where it has generally stayed. The exception to this is 2006 when over 14 per cent of awards were not filed and 2010 where over nine per cent of awards were not filed. Not only do the results indicate that moving to an online and real time filing regime likely streamlined the reporting requirements and was in and of itself an effective method to encourage more regular reporting, but also the results demonstrate that compliance with the filing requirements may have markedly improved.

FIGURE 7 DISTRIBUTION OF THE FREQUENCY OF AWARDS NOT DISCLOSED BY YEAR, 1996-2011



It is important to remember, however, that the number of option awards in a given year grows steadily over the sample period. This means that while the percentage of awards not filed is shrinking, generally the raw number of awards not filed in a given year has not changed much over the sample period. In addition, since the initial transition phase to SEDI there has been little improvement to compliance, except for in 2011 when fewer than three per cent of awards were not filed, which represents a marked improvement in insider reporting.

Is it possible that this trend in compliance was due to greater enforcement, which was a policy recommendation made by M&S (2010)? In an effort to answer this question, I obtain data from the Disciplined Persons Database. In that database, I find little evidence of increased enforcement. I find that only seven individuals have been sanctioned for failing to file in Quebec since March 28, 2007 and 88 individuals have been sanctioned in B.C. since Feb. 26, 1991. The punishments range depending on the number of counts of failure to report of which an individual is found guilty. Interestingly, in Quebec, the seven insiders sanctioned for failure to report were found liable only for failure to report; in B.C., most of the persons sanctioned for failure to report have also been sanctioned for other breaches.

One of the difficulties in interpreting the above results is the amount of overlap between the categories and determining which, if any effect, may be driving the observed trend. This arises because it is not unusual to grant a stock option award as part of the compensation package offered to a new NEO, so that only those new NEOs would get that option award, and that new NEO is more likely to be a VP. However, given that the results suggest that most of the failure to file is the result of an insider's first, and sometimes only, award, it suggests that there is a learning curve — or an initial failure to educate — associated with compliance with insider reporting obligations. This may be supported by the following finding: in reviewing the filings for those insiders who received more than one option award but who failed to file their first option award, I find that many of these insiders subsequently filed an opening insider report (which is required to be filed within 10 calendar days of first becoming an insider) sometime after the (unreported) stock option grant and that the opening report includes the number of options from the initial (unreported) stock option grant.

Based on these results, I offer an important caveat about the displayed increase in compliance I report in Figure 7. The observed reduction in non-compliance could be solely due to sample issues, notably a lack of turnover in the insiders at my sample of companies in recent years which naturally reduces the number of insiders obtaining their "first" award, and not due to an overall increase in compliance. In examining my data, I see that the proportion of first awards steadily fell from around an average of 30 per cent to 15 per cent by 2011. This suggests that perhaps the impression first left by Figure 7, that compliance with the filing requirements may have markedly improved, is only partially true. That is, the observed increase in compliance rates can also be explained by the reduced proportion of first awards in the sample.

Do Insiders File the Required Reports on Time?

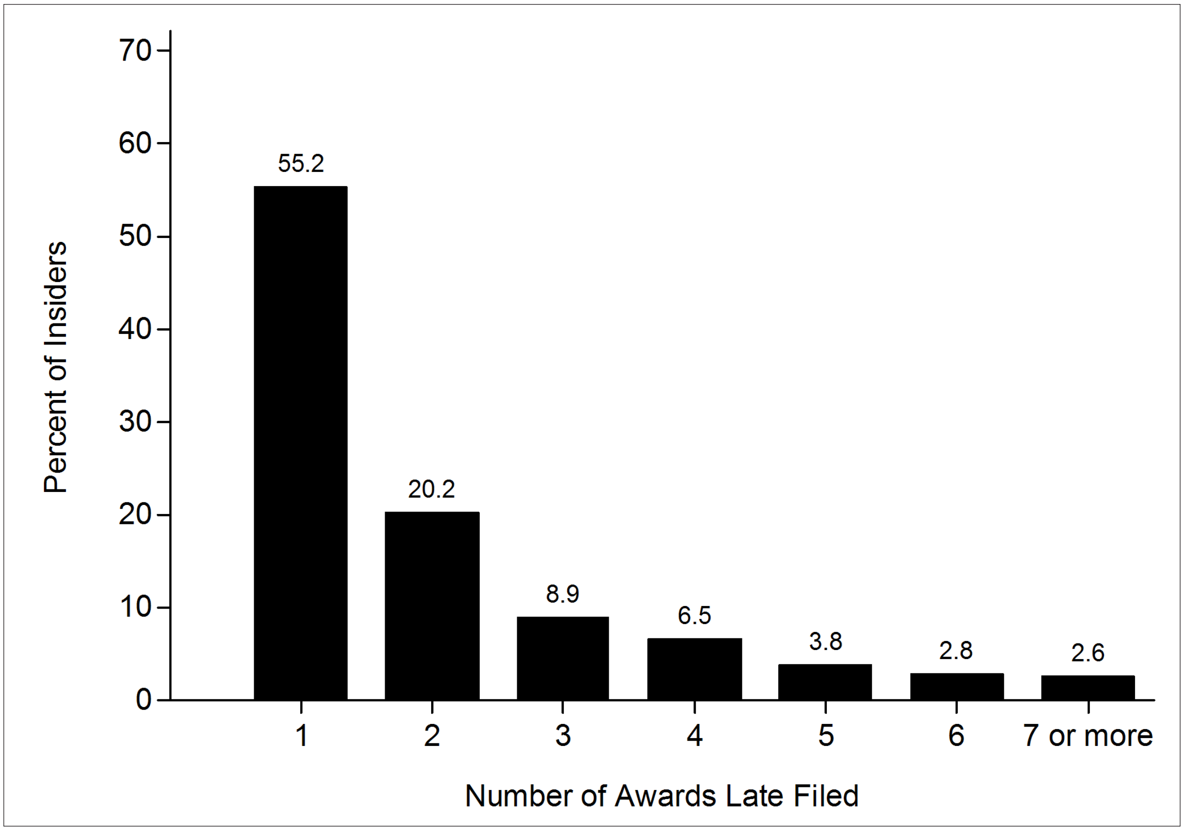
I now focus on the option awards that were filed. Of those option awards that are filed (3,482), I find that nearly 30 per cent of awards over the sample are either published or filed after the required disclosure date. That is, they are filed, or at least for the OSCB period published, late.

In terms of who files late, there is no variation by insider position or by the number of NEOs who receive the award. I also find little variation by award sequence. The only award that has a higher probability of being filed late is an insider's first award, with more than 46 per cent of first awards being filed late. All other awards vary around the overall average of 30 per cent, except for an insider's seventh and higher awards, which only have a 17 per cent chance of being filed late.

It is worthwhile to link this result of a significant proportion of first awards being filed late to the previous result, where it was found that a significant number of insiders who received multiple awards failed to file their first award, but who eventually filed an opening balance recognizing that award. Obviously, it is better from a disclosure perspective for an award to be filed late than never really filed in the first place. To the extent that some insiders are using the opening balance filing to avoid being tainted with a late filing, this behaviour is worrisome for achieving the goals of disclosure.

As mentioned previously, insiders may designate an agent who can file on their behalf. It is possible for an issuer to designate such a person who files the reports on behalf of all NEOs. While there is no indicator in the insider filings of when this occurs, awards to multiple NEOs that are filed with the same information and on the same day may be filed by such a designate. Using this rough guideline, I do find that awards with such characteristics are far less likely to be filed late. I find that 34 per cent of awards to only one NEO, and thus impossible to determine if a designate is being used, are filed late and 28 per cent of awards to multiple NEOs who do not appear to use a designate are filed late. In contrast, only 14 per cent of awards to multiple NEOs that appear to be filed by a designate are filed late. In terms of late filing behaviour by individual insiders, more than 55 per cent of insiders have at least one option award that is filed late and more than 17 per cent of insiders never file on time. If I look more closely at the late filing behaviour of insiders, as shown in Figure 8, I see that most insiders who file late mostly only do so once, but that a concerning minority are fairly regular non-filers.

FIGURE 8 DISTRIBUTION OF THE NUMBER OF AWARDS LATE-FILED BY INDIVIDUAL INSIDERS



In terms of how this has varied over the filing regimes, Table 2 shows that, unsurprisingly, timely disclosure significantly improved with SEDI's advent. Using the OSCB period, nearly all of the awards were disclosed to the public after the required disclosure period. In comparison, for the SEDI period, only about 16 per cent of awards are filed late. While SEDI improved timely filings, the recent move to a five-day filing deadline did not result in a significant decrease in the proportion of awards that are filed late.

Not only did SEDI improve the rate of timely disclosure, but it also improved the time to disclosure. In looking at all option awards, the average number of days from grant date to publication or filing date steadily decreased from nearly 200 days to seven days. In looking at only those grants that are filed late, the average number of days from grant date to publication or filing date, the delay decreased from 209 days to 32 days. The results also show that the range of days to disclosure has also improved. The longest delay in the OSCB period was over five years, whereas this decreased to just over three years in the initial SEDI period and now stands at just under one year.

Could the increase in timely disclosure have been the result of increased enforcement? There is conflicting evidence that fines for late insider reports are effective. Late-filed insider reports dropped by 61 per cent the year following the introduction of the late filing fee in Quebec, suggesting they are effective. On the flip side, while Ontario collected $520,000 in fines for late insider reports, as noted by Compton et al. (2011, 485) "there are few reported cases of enforcement actions brought against late filers except in conjunction with other more serious breaches of securities law." Table 2 also shows that if a report is filed late, it is likely to be filed long after the required filing date. Once a report is late, there is little incentive for the insider to file their reports more quickly. This is likely a function of how the late filing penalty is calculated. As noted above, in Ontario, the penalty for late filing is a relatively modest fine of $50 per day and this fine is capped at a maximum of $1,000 per issuer per year (Fees, OSC Rule 13-502, (2 April 2010), Appendix D (B)). The cap is reached once one award from a particular issuer is late by 20 days. The results suggest that the cap size and calculation need to be reconsidered if they are meant to curb late-filed reports. As a result, there is not sufficient evidence to suggest that late fines are driving the observed results. The improvements in late filing are welcome, but there still remain a large minority of awards that are filed late, a minority of insiders who repeatedly file late, and the disclosure delay is still impeding the ability of disclosure rules to achieve their objectives.

TABLE 2 PROPORTION OF OPTION AWARDS FILED LATE AND # OF DAYS TO FILING

Filing Deadline	Regime	% Published/Filed Late	Mean # of Days from Grant Date to Published/Filing Date [Min, Max] All Grants	Mean # of Days from Grant Date to Published/Filing Date [Min, Max] Late Published/Filed Grants
10 calendar days from the end of the month	OSCB	94.7	199 [21, 1802]	209 [21, 1802]
10 calendar days from grant date	OSCB	98.6	110 [7, 1836]	112 [18, 1836]
10 calendar days from grant date	SEDI	17.4	18 [0, 1103]	78 [11, 1103]
5 calendar days from grant date	SEDI	15.3	7 [0, 323]	32 [6, 323]

It could be that features of the option award itself may decrease the ability of an insider to be able to file their award on time. Notably, awards that are priced not using a trading price on the day of or day before an option award may result in late filings due to a delay in the insider being informed of an option award. In particular, it may be that the time needed to calculate a stock option awards exercise price when a five- , seven- or 10-day average is used may lead to an increase in late filings. Interestingly, the data show that options that are granted with an exercise price based on stock trading information from multiple days are significantly more likely to be filed on time than those priced using the trading price from the day of or day prior to the option grant. This is an interesting finding that is worthy of more detailed follow-up as the higher incidence of late filing of stock options priced using a simple pricing model could be evidence of backdating of stock options.

Are Insider Reports Accurate?

The final thing to consider is whether insider reports are accurate; this includes examining the reports for missing required information along with mismatching information. I first consider if information from the insider reports is missing, ensuring that I account for the limited information available through the OSCB. I consider information to be missing from the report if the entry is blank or if zero is entered in lieu of informative data. I find that nearly 10 per cent of insider reports contain missing information, and that this is worse under the SEDI reporting system. Notably, only 3.3 per cent of OSCB reported awards have missing information, whereas 10.3 per cent of awards reported on the SEDI system have missing information.

In terms of the data that are missing, most of these cases involve the options expiration date. Since the OSCB does not report this information, these cases are all filed on the SEDI system. The remaining cases involve either the exercise price or, in one case, the number of options not being reported. If the expiration, exercise price and number of options are all considered required information, it is curious that the SEDI system would allow the report to be submitted either with missing information, or using zero when non-zero information is expected, rather than generating an error code that prompts the insider to fill in the missing information. In most cases where the expiration date is missing, these are laddered awards with different tranches of options having different expiration dates. Clearly, insiders are confused about how to file such awards and need guidance as to how to do so.

In terms of inaccurate information, nearly 34 per cent of insider awards are filed with information that does not match that reported in the information circular. The proportion of awards filed with inaccurate information is higher on the SEDI system than the OSCB system. During the OSCB regime, 25 per cent of awards were inaccurate, whereas during the SEDI regime it is nearly 36 per cent. Most of this inaccuracy is due to mismatching expiration dates or the grant date. While a small proportion, there are insider reports that report the wrong exercise price, the number of options, and even the security designation in a handful of cases.

However, it is important to account for filing amendments before considering inaccuracies any further. Insiders can file amendments to the original filings to correct any information provided in the original filing. I find that approximately seven per cent of insider reports are amended after the initial filing, nearly all of which occurred after the SEDI's implementation. This is likely due to the ease of an insider being able to check their original filing and the ease of filing an amendment on the SEDI system, rather than the original filings in the OSCB regime being more accurate.

The most common information amended is the grant date, followed closely by the exercise price and expiration date. Interestingly, in some cases (one per cent) the original reported information matched that reported in, or that imputed by, using the stock option granting information in the information circular, meaning that the amended insider report is inaccurate. All of these cases involved either or both amending the grant date and the exercise price. It could be that insiders are erroneously filing amendments when an alternative filing (e.g., a repricing) is required.

While data input errors are to be expected, what is more concerning is the amount of time that potentially incorrect information remains public. A minority of these amendments are ones that occur on the same date as the original filing, but most occur long after the original filing: the average number of days between the original filing is nearly a year (338 days), and the longest gap between the two is over five years. Because the distribution is highly skewed, considering the median amendment delay is important, which is 105 days. If I only consider those insider reports where the amendment results in the reported information matching that in the information circular, the delay actually increases to an average of over a year, at 380 days, with the median being 140 days. This means that investors and others using disclosure information as it is intended to be used may be making decisions based on erroneous information that remains public for an extended period of time.

For the remainder of this section, I use the data that are corrected for the amended information, where the amendment does not result in initially correctly reported information being modified with incorrect information. Overall, I find that after correcting for amended information in this way, nearly 32 per cent of awards are inaccurate, with one-sixth of these having more than one error. Table 3 shows how these errors are manifested across the categories. Misreporting the security designation is very rare. With respect to the 11 insider reports with an incorrect designation code, most codes are for different derivatives than options (e.g., rights, warrants, ownership) and this could be the result of simple confusion on the insider's part or the result of the issuer's information not properly disclosing the derivative in its table.

An equally small proportion of insider reports misreport the number of securities and exercise price. In some cases, the error appears to be one of simple data entry, with numbers inverted or an extra zero added or omitted. With respect to the number of securities, a number of insider reports report a negative number of options granted despite the proper security designation of "Option Grant" being used. With respect to the exercise price, in some cases the difference is simply the result of the insider reporting a different number of decimal places than that reported in the issuer information circular. In most cases, there is no clear reason for the difference, but the frequency of these errors is fairly low.

Errors related to the grant and expiration date, however, are much more common. Nearly 11 per cent of insider reports provide the wrong grant date and 22 per cent the wrong expiration date. With respect to the grant date, more than one-quarter of reports with errors are off by one day on either side of the grant. With respect to the expiration date, nearly half of reports with errors have the same feature. In these cases, I find that this may be the result of wrongly aligning the grant date with the expiration date. For many option awards, the expiration date is set as one day less the grant date sometime in the future. For example, the options are granted on Feb. 1, but they expire Jan. 31 as opposed to Feb. 1 sometime in the future. Some insiders seem to be confused by this and either change the grant date or expiration date to align with a full year.

However, in the majority of cases, the grant date is off by an order of magnitude. The average difference between the actual grant date and that reported by the insider is 49 days with the maximum difference being five years. The actual grant date of the stock option award is one of the most crucial pieces of information for the public. Why would an insider provide the wrong grant date? As noted by Compton et al. (2011, 481-482), it is possible that the issuer does not inform some insiders of their awards in a timely manner. In such instances, and through no fault of their own, insiders are not able to file their insider reports in a timely fashion. Canadian securities commissions have a practice of allowing insiders to use the notification date as the grant date for the purpose of insider reporting.[24] Doing so typically ensures that the insider is not reported as being a late filer.

TABLE 3 DISTRIBUTION OF ERRORS IN INSIDER REPORTS

Error	% of all awards	Mean [Std. Dev]	Min & Max
Any Error	31.8%		
Number of Errors		1.15 [0.38]	1, 3
Security Designation	0.3%		
Number of Securities*	1.0%	-89,139 [254,155]	-1000000, 100000
Exercise Price*	2.6%	-10.59 [16.85]	-58.59, 0.71
Grant Date*	10.9%	48.42 [157.2]	-357, 1826
Expiration Date*	21.9%	8.71 [864.75]	-3686, 3513

* Denotes mean and minimum/maximum reported is the difference, calculated by taking the amount reported by the insider and subtracting that reported in the issuer information circular.

The practice of allowing insiders to use the notification date in place of the grant date has two consequences. First, the number of reports that are filed on time is overstated. Securities regulations require that insider reports be filed within a narrow window from the grant date. Insiders who use the notification date in lieu of the grant date may appear to file in a timely fashion when they have not in fact met the requirement under the legislation. Second, the public is provided with incorrect information. The notification date may be within a few days of the grant date, but it can also be weeks, months or even years after the actual grant date. The grant can appear to be either in-the-money (where the exercise price is below stock price on the "grant" date) which violates TSX exchange rules (TMX, 2010, 11) or out-of-the money (where the exercise price is above the stock price on the "grant" date) which gives it the appearance of a performance-based award rather than a compensation-based award.

[24] As noted previously, the grant date of an award is that date when the legal steps necessary to authorize the issue of the options (including necessary stock exchange approvals, if any) have been completed. Once these steps are completed, the recipient must then be notified of the grant. Legal notification of an option award can come either with or without a grant date. If the notice has a grant date on it, then the officer must file the insider report within 10 days of that grant date. What happens if the notice does not have a grant date? CSA Staff Notice 55-308 (n.d.: repealed in 2010) contained the following response to "When do I need to report options I acquired under a company stock plan?":

You need to report the grant of stock options because you have acquired securities of the company. You need to report the grant within 10 calendar days of the date you legally acquire ownership of a specific number of options, i.e., the date indicated as the date of grant ***or if no date is given, the date you are notified of your specific allotment***. If the grant is subject to approval by a stock exchange, then the date of grant can be no earlier than the date exchange approval is granted. The date the board of directors of the issuer merely authorizes the grant of options is not the date from which you calculate your requirement to report your grant." (p.11) (Emphasis added.)

CSA Staff Notice 55-308 was replaced by *Questions and Answers on Insider Reporting and the System for Electronic Disclosure by Insiders (SEDI)*, CSA Staff Notice 55-316 [CSA Staff Notice 55-316] , which did not include a similar question and answer, so it is unclear if this is still accepted practice.

In the remaining case, the expiration date is off by an order of magnitude. In a number of cases, the insider seemed to erroneously provide the grant date in place of the expiration date. In other cases, the error may be the result of a laddered grant. However, it is difficult to provide clear explanations for many of the errors. It could be that there is an underlying strategic reason for the misreporting and that possibility is worthy of more detailed follow-up.

VI. RECOMMENDATIONS

The methodology, data collection and results detailed above lead to a number of recommendations which can not only improve disclosure under the current rules, but also the ability of securities regulators to monitor and enforce compliance with the existing disclosure rules. I show that the approach of using third-party reporting and data matching to investigate compliance with disclosure rules is a viable methodology due to the presence of both insider and continuous disclosure in Canada. However, the continuous disclosure requirements along with the nature of the databases where this information is available pose significant barriers to this work. Dismantling these barriers, however, serves multiple purposes, including providing shareholders with more detailed information regarding NEO compensation, increasing the ease at which compliance can be investigated, and streamlining issuer and insider reporting. In addition, the results show that education on the disclosure rules is needed as is a detailed consideration of the filing requirements and rules.

1. Change the Reporting Template in the Issuer Information Circular

Since 2008, the securities regulators have stipulated the template in which the issuers must disclose stock option awards in their annual information circular. The template, however, impedes transparency. Greater transparency can easily be achieved by small modifications to the template, requiring the issuer to report the grant date, and removing the limit to disclose only unexercised options. This information is readily known and requiring it to be provided does not impose a significant burden. Indeed, issuers often volunteered this information prior to 2008.

In addition, consideration should be given to requiring the issuer to provide the stock's market price on the date of the grant award. This information should be supported with footnotes to the table as to how exactly the exercise price and the market price were calculated. As mentioned, while issuers are required to report and follow their general stock option pricing method in the circular, this information is overly generic for determining the exact pricing method used for any given stock option award, meaning that it is difficult to determine compliance with the shareholder-approved stock option plan. Finally, the issuer should be required to report in the summary compensation table the date each NEO became or ceased to be a NEO. While the SEDI system requires this information to be reported, few insiders actually provide it. As the disclosure rules are based on the insider and NEO status of an individual, it seems important that this information be provided.

It is also plain that issuers are not clear or consistent in how they report laddered stock option awards in their proxy reports, suggesting that issuers also need better and clearer guidance in this area. In reviewing the disclosure manuals provided by the securities agencies, I find no clear direction on reporting requirements of such option awards. Clear guidance regarding the reporting of more complex stock options grants appears to be needed and will assist in more informative continuous disclosure. Equally, similarly clear guidance needs to be provided to insiders who also struggle to properly report such option awards.

Further, the issuer could be obligated to provide information regarding its NEOs' compliance with disclosure rules. For each issuer, the number of NEOs for which it would have to provide this information is fairly insignificant, amounting to about five people a year, depending on turnover. Such a compliance table would serve to be not only informative to shareholders, but also to the securities regulators, as it provides simple digestible information to inform audit and compliance activities. Compiling such a table would be much simpler for the issuer if it were responsible for the insider filings, a point I return to below.

Such minor changes to issuer reporting not only provide important information to shareholders to ensure they are fully informed on the compensation to the issuer's NEOs, but also provides important information to the securities regulator so as to inform and investigate compliance with disclosure rules. The former is important given the proliferation of "say on pay" initiatives and the latter is important for ensuring disclosure achieves its objectives. Indeed, it seems quite efficient to ensure that continuous disclosure achieves these multiple objectives given the low cost of doing so.

2. Improve the Continuous Disclosure Database

SEDAR, the continuous disclosure database, was launched in 1996 and appears to operate in the same way, 20 years later. This archaic reporting system now works to hinder anyone wanting to access and use the information available on this website. Notably, the requirement to submit PDF versions of documents, along with the search tool being limited to only being able to access the information issuer, significantly limits the usefulness of the information reported to the database. In fact, it could be argued that the SEDAR system provides little benefit over dissemination by a town crier. After all, data that are difficult and (time) costly to access impede the sole purpose of disclosure: that of informing investors, broadly defined.

While modernizing the SEDAR database may require some investment on the part of the securities regulators, it can be worth the cost if proper thought is given to aligning the database to also satisfy audit compliance activities. If at a minimum, the summary and stock option compensation tables were available in machine-readable data, this would provide significant benefits to shareholders, investors, securities regulators, journalists and other researchers. It would also be beneficial if the data were more easily and generally searchable and downloadable. Finally, despite the important tandem nature of both insider and continuous disclosure, the two databases (SEDI and SEDAR) are not linked. This is unfortunate, as linking the information can streamline insider filing requirements, increase compliance with insider disclosure, and improve the audit and compliance function of the securities regulators.

For example, if the issuer is required to provide the date that an individual becomes a NEO, which necessarily means the individual is an insider, then this information can be linked to the individual's SEDI profile and auto-filled upon issuer submission. Further, the issuer disclosure of an insider stock option award can be immediately linked to an insider's SEDI profile, providing an immediate cross check and a flag generated if the information is not provided or differs from what the insider provided. In short, linking the databases can automate compliance checks, thereby reducing audit costs for the securities authorities. Linking in such a manner would also aid the aforementioned recommendation that issuers provide information in their annual proxy statements about compliance with disclosure rules, thereby reducing the costs on issuers for such a requirement, which may reduce backlash to such a reporting requirement.

3. Improve the Insider Disclosure Database

While the SEDI system is leaps and bounds a better interface than the SEDAR database, there is much room for improvement. Much like the SEDAR system, the search tool is limited, requiring you to search either by issuer or insider as opposed to more generally, such as over a time frame. The SEDI system also has a frustrating report limit. That is, it can only provide so many reports in one search and many larger companies exceed its limits. When the limit is exceeded, you must limit your searches to SEDI-digestible chunks to view the information. This is an unnecessary limitation in this era of computer power and Internet bandwidth.

In addition, it is concerning that the same information can often not be located through independent searches of issuer and insider. The fact that many insiders are not properly linked to their issuer is problematic for disclosure. It is equally concerning that insiders are not being required to fill in key information like the date they became or ceased to be an insider.

The SEDI system also allows insider reports that do not meet basic criteria. SEDI continues to allow insiders to file opening reports that have a positive balance, allowing some individuals to circumvent proper and full disclosure of awards. SEDI also allows reports to be filed that omit required information. As previously noted, regulation requires that SEDI reports include expiration and grant dates, price and number of options. Therefore, failing to include any of this information represents improper disclosure. When information is missing from SEDI reports, transparency and efficiency are weakened. Undisclosed information may dilute investor confidence, leading to reduced market efficiency. Alternatively, it might make it difficult for authorities to recognize improper trading. A missing price, for example, makes it all but impossible to recognize inconsistencies between stock data and grant date information. As discussed, reporting regulations are in place to ensure continued efficiency and market growth as Ill so as to deter improper trading. Incomplete information in filings threatens these goals. Finally, SEDI allows reports to be filed that have obvious errors, including entering the number zero when a non-zero entry is expected, allowing a negative number to be imputed for the number of securities associated with a stock option award, and expiration dates that pre-date the awards grant date. All of these issues can easily be addressed by simple changes in the SEDI data interface which does not allow reports with these characteristics to be submitted.

4. Improve Insider and Issuer Education

The results make it clear that failure to file and late filing are highly associated with an insider's first award. This result suggests that simply increasing fines and punishments for non- and late-filing may not be the most effective avenue for increasing filing and improving timely filing. Instead, the results suggest there is room for increased clarity regarding insiders' obligations. This includes a focus on education regarding the opening insider report and the importance of filing every award, even their first award. Companies appear to be in the best position to educate their insiders on their reporting requirements, particularly since they know when a person becomes an insider and when these insiders receive awards. Issuers also need to be informed of the obligation to educate their insiders, ensure their insiders comply with the disclosure rules, and that they themselves comply with continuous disclosure. Such education could include a required online self-paced class for all new insiders and issuers to complete. This course could be linked to the SEDI filing requirements so that a report cannot be filed until the course is completed.

5. Shift Filing Onus

In conjunction with, or alternatively to, insider education, companies might be encouraged to file reports on behalf of their insiders, thereby eliminating the concern that an executive could fail to file due to inexperience or lack of knowledge about requirements. After all, it is found that options awards that appear to be reported by an agent are less likely to be misfiled. As noted by Compton et al. (2009, 388-389) "the company possess all the information concerning the grant of stock options to insiders and therefore is better placed to ensure that all such grants are reported on a timely and accurate basis" (Compton et al. 2009, 388-389). Moving to such a regime could improve the timeliness of disclosure as companies can file the reports almost immediately upon granting the options.

Additionally, issuers could be required to issue a public press release on the day of any option grant as is required in the U.S. and for companies listed on the TSX Venture exchange. A public press release is a low-cost way of ensuring immediate, publicly available information about insider stock option awards.

6. Apply Penalties

Some individuals are chronic non-filers and more file sporadically. Both actions suggest a disregard for the regulations as Ill as the rationale for insider disclosure. Financial penalties should apply to chronic non-, late and erroneous filers. The penalties should be structured so that the maximum cap on them does not exacerbate the filing problems, and structured to correlate to the degree of the infraction. For example, penalties could be increased for multiple late-filers and/or for the length of the delay in filing.[25] However, for such fines to be effective they must be enforced; yet, fines and penalties tend to be imposed only as part of enforcement actions that also involve more serious breaches of securities law. It could be

[25] For example, the Income Tax Act contains a number of graduated fines or penalties for late-filed information or for multiple infractions of the same requirement. See, for example, the various penalties set out in section 162 of the Act. Subsection 162(7.01), provides various financial penalties of a dollar amount per day multiplied by the number of days that the required information is reported late (subject to a cap).

argued that more serious breaches could be minimized if more effective action were taken on lesser breaches, such as failing to file an insider report. Regular cross checks between company records and insider filings, perhaps even requiring the companies to conduct these cross checks, could provide a simple way to enforce the rules and to take the appropriate action to curb non-compliant behaviour.

7. Revise Practice of Allowing Insiders to use the Notification Date for the Grant Date

As was noted, a concerning minority of insider reports report a grant date that is at odds with the issuer's information. It was discovered that the securities regulators allow insiders to use the notification date in place of the grant date, despite the clear implications for the objectives of disclosure. The incorrect reporting of the grant date can be overcome in several ways. First, current securities policy simply states that the issuer must inform the insider of a stock option award in a "timely manner" but this is not enshrined in legislation. Securities legislation could be revised to require issuers to notify insiders of stock option awards within a specified short time period. For example, the U.K. requires that insiders be notified within two trading days. Since Canadian insiders are currently required to file their report within five calendar days of the grant, a two-day notification period should permit timely filing. Second, the SEDI system could be modified to include entry of the notification date in addition to the grant date, and the notification date used to determine if a report is filed late. The simplest solution, however, seems to be one that was previously listed: require the issuer to file the insider report when a stock option is awarded, as is done in the U.K. and Australia. National Instrument 55-104 already gives issuers the option to file stock-based compensation reports on behalf of insiders and the timeliness and accuracy of reports tend to improve under such a system. Again, it is the issuer who holds perfect information about the option awards.

8. Detailed Consideration of the Filing Requirements and Rules

Of course, the recommendations above are based on the assumption that the existing disclosure requirements and rules are desirable. This study simply investigates compliance with the existing disclosure rules and makes note of where there are compliance issues with these existing rules. It may be worthwhile for the securities regulators to potentially first consider if the existing rules themselves need to be revised, given their objectives and given how the market has changed over the last 20 years. For example, is all the information that is required to be disclosed informative to these objectives? Is more or less information desirable? Is more timely disclosure important and if so to whom? And how can we ensure compliance with all the disclosure rules? Should compliance be better embedded in the system?

VII. CONCLUSION

Missing, late and misleading insider reports have been, and continue to be, roadblocks to achieving the goals of reporting requirements. The good news is that late and nonfiled awards appear to have diminished over time, particularly with the launch of the SEDI reporting system. The bad news is that reports with errors and omissions of data have not diminished over time or with the advent of SEDI. In fact, errors and omissions increased with the SEDI reporting system. Based on the results detailed above, a number of recommendations are made which cannot only improve disclosure, but also the ability of securities regulators to monitor and enforce compliance with the disclosure rules. The results also point to fruitful avenues of future research including more detailed analysis of non-, late and misfiled awards, and options award timing practices, including whether the underlying trends point to more strategic behaviour than the descriptive statistics show. This includes examining issuers' characteristics and their insider compliance, and whether underlying poor disclosure is more strategic, and possibly nefarious, behaviour.

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