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Learning to Play by the Disclosure Rules: Accuracy of Insider Reports in Canada, 1996-2010*

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Abstract: Insiders of Canadian reporting issuers are required to file public reports when they acquire, buy, or sell securities of that reporting issuer. These public reports must be filed using a prescribed form and must be filed within a specific time frame. Failure to file these public reports or filing with inaccurate information constitutes an offence under securities law. The two main objectives served by these reporting rules are: (1) primarily as a regulatory tool to detect or prevent the improper use of undisclosed information by insiders; and (2) to increase market efficiency by providing investors with information concerning the trading activities of an issuer. These objectives are dependent on compliance with the rules, yet no information regarding compliance exists. To investigate compliance a secondary source of information to verify the information provided in public reports must exist. In Canada, the CEO and the top four highest paid executives must report detailed information regarding their compensation, including stock option awards, in the annual report to shareholders. We collect information on stock option grants for these individuals for a sample of Canadian public companies for the period 2003-2011 and compare this information to that provided in the public reports. We find that while the majority of executives properly and accurately file public reports, a significant minority fail to file or file inaccurate information. We consider the consequences of this finding and suggest ways to improve the quality of insider reporting in Canada.

Keywords: Securities Regulation, Compliance, Insider Disclosure, Continuous Disclosure, Employee Stock Options, Insider Trading

JEL Codes: G38, K22, M12

1. Introduction

Securities regulators have long been concerned with correcting the information asymmetry that exists between investors and corporate executives. Their concerns are primarily related to insider trading: the ability of senior executives and other individuals with access to confidential information about the activities of a company (known as "insiders") to exploit that information for financial gain, potentially at the expense of investors.[1] According to regulators, 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.

A popular approach to overcoming insider trading, apart from criminal sanctions, is through disclosure rules which require reporting issuers[2] to file periodic reports (known as continuous disclosure) and 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). Disclosure rules attempt to: (1) provide transparency, (2) detect and prevent improper use of inside information by insiders for material gain, and (3) maintain confidence in financial markets. Disclosure rules were embodied in the *Securities Exchange Act of 1934* (Pub L No 73-291, §16(a), 48 Stat 881 (1934) (codified as amended at 15 USC §78a-78kk (1994)) [*Exchange Act*]) in the U.S. but were not adopted in Canada until 1966.

As a result of insider disclosure requirements, select insiders of Canadian reporting issuers are required to file public reports when they acquire, buy, or sell securities (including stock option awards) of that reporting issuer. These public reports must be filed using a prescribed form and must be filed with the correct public body within a specified time frame.

Failure to file these public reports or filing late or inaccurate information constitutes an offence under securities law. Unfortunately, little is known about insider compliance with the disclosure rules in Canada. Do insiders file on time or at all? Are the reports accurate? Are there any checks in the system? Have recent changes to reporting requirements made any difference in compliance rates? In effect, do insider disclosure rules achieve their objectives?

McNally and Smith ([M&S] 2010) recently began to investigate some of these questions by examining the accuracy and timeliness of insider disclosure of equity trades in Canada. Their approach was to impute reporting errors based on observing daily share information and found that errors have tapered in recent years and disclosure has become timelier. That said, they still recommended that penalties for misleading and late disclosure be increased.[3] There remain several unanswered questions from M&S's (2010) work, including whether their findings are generalizable to all insider acquisitions, whether the observed errors are intentional or unintentional, and whether errors decrease with the insiders' experience with disclosure. In addition, due to the approach taken by M&S (2010), they are unable to determine the proportion of insiders that even file the necessary reports. Their work represents a limited but important contribution to the emerging literature on disclosure compliance.

The purpose of this paper is to further explore the extent and intensity of compliance problems associated with insider disclosure in Canada. We argue that the optimal way to investigate compliance is to use third-party information to verify the information provided by individual insiders in public reports. Using third-party reporting allows for the broadening of the types of errors that can be investigated, particularly determining the extent and intensity of reports that are not filed at all, as well as increased ability to contextualize the probable cause of

the errors and omissions. Importantly, this secondary source must contain accurate information with which to check the insider reports against. A secondary source is not available for most securities but is available for some insider stock option awards and arises out of the continuous disclosure rules. As part of the continuous disclosure requirements, reporting issuers must report detailed information regarding the compensation paid to certain executives, including stock option awards, and this information must also be included in the mandatory annual information circular (hereinafter proxy circular) to shareholders. Given the value of annual executive stock option awards,[4] existing stock option stockpiles among Canadian insiders, [5] and concerns related to levels of executive compensation and manipulation of these securities,[6] there is a public interest in timely and accurate disclosure of these compensation instruments.

We collected information on stock option grants for select executives for a sample of Canadian public companies for the period 1996-2010 from proxy circulars. We then compared the proxy circular information on stock option grants to that provided by the individual insiders in their public insider reports. Matching stock option grants to two separate documents and comparing the reported information allows us to better understand the nature and origin of the errors. As our study period spans several amendments to the insider filing regime, we can also examine whether and to what extent various changes have improved insider reporting. All this information will allow us to better determine the appropriate corrective policy for improving disclosure particularly of stock option awards.

We find that while the majority of executives properly and accurately file public reports, a significant minority fail to file, file late, or file inaccurate information. We consider the consequences of these findings and suggest ways to improve the quality of insider reports. This

paper argues that the existing rules, while an improvement over earlier insider reporting regimes, still suffer from shortcomings, which unfortunately diminish the intended purpose of insider reporting. We also show that the timing and characteristics of inaccurate, late, or unfiled awards suggest that M&S (2010) recommendations for increased penalties is an incomplete approach to addressing ongoing issues with insider reports.

The remainder of our paper proceeds as follows: Section 2 provides a brief history of insider reporting; Section 3 outlines the current insider reporting system; Section 4 outlines continuous disclosure requirements; Section 5 discusses data collection; Section 6 reports on and discusses the results of our data analysis, offering recommendations for future improvements to reporting mechanisms; and, Section 7 concludes with a brief review of our purpose and findings.

2. A Brief History of Insider Reporting in Canada

The need for insider disclosure rules in Canada originated principally from 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,[7] 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 regulation.

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 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 were 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. These two disclosure recommendations were first introduced in Ontario in 1966 and later introduced in all remaining provinces.[8] 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.

3. Insider Disclosure Requirements in Canada

Insider disclosure (ID) places 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). Compton et al. (2011) provide a recent and detailed account of the insider disclosure regulations and requirements in Canada, which we summarize here as they apply to the reporting of compensatory stock option awards over our period of study. This summary provides answers to the following question: who is required to file insider reports; what information needs to be included in these reports; when do the reports have to be filed; how are the reports filed; and to whom are the reports filed.

While Canada defines "insiders" quite broadly, especially when compared to other jurisdictions such as the U.S. and Germany, those insiders who are required to file insider disclosure reports has generally been defined more narrowly. Until recently, securities regulators provided exemptive relief to the reporting requirements "on a case-by-case basis in response to applications" (CSA 1999, para. 6). *Insider Reporting Exemptions,* NI 55-101, Part 2 and 3 (Rescinded) [NI 55-101] narrowed the reporting requirements by detailing those insiders who were exempted from ID. 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.[9] A reporting insider includes the CEO, CFO, COO, director, or a person responsibility for a principle unit of a reporting issuer.

The information that is required to be provided in the insider report is contained in the System for the Electronic Disclosure by Insiders (SEDI) user manual (Canadian Securities Administrators [CSA], 2008).[10] The insider must provide the security designation, which in the case of typical employee stock option awards is "Options (Common Shares)", and ownership type ("Direct Ownership" for stock 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 nature of the transaction ("Grant of Options") must be provided, along with the number of options acquired, the exercise price, the currency at which they were awarded, and the expiration date of the options.[11] The insider may designate an agent who can "file information on behalf of insiders" (CSA 2008, 93).

While there are no specific penalties for filing erroneous or misleading reports, all of the provinces do have general provisions that make it an offense, 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 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 $1,000,000 and $5,000,000. However, in practice, these laws have not been applied to improper insider reporting. Indeed, we are not aware of any case where an individual was charged with producing misleading insider reports.

The required information must be filed within a certain amount of time from the transaction date. The filing deadline has changed three times since 1996. Until 13 December 1999, insiders were required to disclose options awards within ten calendar days of the end of the month in which the options were granted. For example, if an award was made on 8 March 1997, the insider was required to submit a report of that award by 10 April 1997. From 14 December 1999 to31 October 2010, the insider report had to be filed within ten calendar days of the grant date[12]. Since 1 November 2010, the reporting period has been five calendar days.[13]

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 February 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 CarswellOnt 3023, 29 O.S.C.B. 4171).

Since 9 June 2003, all insiders must file their reports on 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 (13 June 2008) [NI 55-102]). SEDI replaced an antiquated paper-based reporting system. In

theory, the move to a 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. Market efficiency may be enhanced through increased timeliness of reports. Investors have access to insider reports as soon as they are filed, which may lead to better knowledge and greater investor confidence. Under the old paper-based system, the public had to wait until the reports were published. For example, reports filed with the Ontario Securities Commission (OSC) were published in the weekly OSC Bulletin (OSCB).[14] The accessibility of SEDI may also encourage ethical behaviour by making it easier for investors and other members of the public to view the actions of insiders. The increased visibility of insider activities may discourage insiders from engaging in questionable practices.

The final issue to consider is to whom insiders file their reports. Reporting insiders are required to report to the securities commission in every jurisdiction where the issuer is a reporting issuer. This means 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. SEDI has eased the complication of filings in multiple provincial jurisdictions.

4. Continuous Disclosure Requirements in Canada

Continuous disclosure (CD) places a reporting requirement on the company as a way to improve management, curb fraud, and ensure that all investors have access to the same information, particularly before a shareholder vote (Ontario 1965, 49; MacIntosh & Nicholls 2002, Chapter 9). CD includes 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.

Much like insider disclosure rules, the requirements for what is to be included in proxy circulars have expanded over the years. In the 1980s and 1990s, most jurisdictions added rules for the inclusion of information on executive compensation. This occurred just as the amount of executive compensation began to soar and increasingly included long-term performance awards such as stock options, resulting in an increasing concern regarding the link between executive compensation and insider trading. At that time, reporting issuers were required to provide compensation information on the five highest paid officers in the aggregate.[15] In 1993, Ontario required reporting issuers to include a breakdown of that compensation,[16] following similar changes in the U.S. (Johnston and Rockwell 2006, 98). 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 usually are the CEO, CFO, and three other most highly compensated officers (VPs).[17] Companies are expected to provide details of all forms of compensation for each NEO, combined with additional information on the rational for type and amount of compensation. Each company must also provide objectives of the compensation program. In the case of stock options, this usually means outlining long term goals like performance enhancing 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. Companies are also expected to disclose particulars of all options granted to NEOs in a particular format. 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, but this information is not required. When the grant date is not reported, it can usually be inferred by referencing the expiration date and the typical term of options outlined in the options plan.

We assume that the information provided in proxy circulars is highly accurate for several reasons. Proxy 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. Proxy 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. Finally, these filings are subject to regulatory scrutiny including random audits by securities regulators and the consequence of disclosure irregularities can be material.

Since 1 January 1997, all reporting issuers have been required to file their CD documents, including the proxy circular, on the System for the Electronic Document Analysis and Retrieval (SEDAR).[18] The purpose of SEDAR was to create a public electronic forum where companies could file required reports without filing paper documents in multiple jurisdictions.[19]

5. Data

The inclusion of stock option award information in both ID and CD requirements provides an opportunity to assess the accuracy of insider trading reports. Our approach allows us to determine compliance with reporting rules, particularly the extent and intensity of failing to file the required insider reports. We can also determine whether the information provided by insiders is accurate, what specific information is inaccurate, and what actions might redress these inaccuracies in the future. Table 1 provides a summary of our data sources and the types of information contained within each data source.

[insert Table 1 here]

As discussed previously, while issuer and insider reports are easily accessible through online reporting mechanisms, the data collection and matching process is still extremely tedious. To keep the data collection and matching to a reasonable scale, we defined a sample of 121 companies that were trading on the TSX as of 31 December 31 2010.[20] The sample of companies reflects; (1) large and small companies; (2) new and old companies; and (3) companies that graduated from the TSX-V. Such a mix helps to ensure a blend of differing levels of and experience with corporate governance as well as knowledge of and exposure to securities regulations.

Using this sample, we collect data on stock option awards from the annual proxy circulars posted on SEDAR between 1996 and 2010.[21] Proxy reports are obtained by searching the SEDAR database by company name. We download all the available proxy circulars for each company and review each document[22] for the compensation information and stock option awards for the five NEOs for each company. The information for stock option awards[23] is then transcribed into a database. We also record any relevant information about changes to 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 granted) and the expiration period of stock option awards. This information is used when inaccurate or incomplete information is provided to help determine the true information and the nature of the inaccuracy (e.g., if the issuer does not report the grant date of the option).

SEDAR includes a feature that links companies that have merged or have changed names. This allows us to expand our sample to include previous incarnates, parents, or companies absorbed by the company included in our original list. That is, if a company on our list was created from one or more previous companies, we then added the previous companies to our original list and collected compensation data on them as well. Through this process we added an additional 32 companies for a total of 153. However, 34 companies did not grant options during our sample period, leaving a total of 119 companies. We also excluded income trusts, further reducing the number of companies to 106.[24]

Our 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. Insider reports filed after June 2003 can be obtained directly from SEDI. Insider reports filed before

June 2003 were all paper-based. The paper reports were sent to the appropriate securities commission, which passed them on to a third party (e.g., the OSC used Micromedia) for management and filing. Once filed, the information was then eventually published in a periodic securities bulletin.

Obtaining insider filings for the OSCB period is challenging. Original paper-based filings can only be obtained directly from the appropriate securities regulator. For all TSX listed companies, these reports can be obtained from the OSC but only at significant cost.[25] The OSC did publish the data from insider reports in its weekly OSCB and this data is also available in digital format directly from the OSC.[26] The data from the OSCBs contains all the information provided by the insider in the paper-based report but omits the date the reports were received by the OSC. Consequently, we are unable investigate compliance with filing deadlines in the OSCB regime.

We obtained the stock data for each issuer from the Canadian Financial Markets Research Center (CFMRC) or Yahoo! finance database to verify or impute grant dates. The CFMRC database is updated annually so Yahoo! finance is used to obtain updated stock data. In addition, Yahoo! finance only includes stock data for currently trading companies whereas CFMRC also includes de-listed TSX listed companies. In all cases, we are most interested in the daily closing price of an issuer's stock. This is the price that issuers typically use to set the exercise price of their options (assuming that the options are not back-dated[27]), using either the closing price on the day before the option award or a trade-weighted average of closing prices from either five or ten previous days before the option award, as stipulated in the issuer's stock option plan.

6. Results and Discussion

Table 2 presents summary statistics. Our sample is comprised of 2,716 awards to 723 named executives employed by 106 publicly traded companies. The average base salary ($ 2002) of these executives was $237,139, ranging from $0 to $5.54 million, and the average bonus ($ 2002) was $251,413, ranging from $0 to $9.92 million. The average number of options granted per award was 153,810, with the awards ranging in size from 1,875 to 7.5 million. The average value of these awards on the award date, calculated by multiplying the exercise price by the number of options awarded was $1.28 million, ranging from $5,000 to $87.5 million.

[insert Table 2 here]

Approximately 29 percent of the awards are to the CEO, 22 percent to the CFO, and the remaining 49 percent to VPs and other senior officers. In the majority of the cases, identical stock option awards are provided to more than one NEO at the same time. The most common type of award (52 percent) is one that is provided to all NEOs.

Figure 1 displays the distribution of the number of stock option awards over our sample period. Of the 2,716 awards, 380 (14 percent) were granted before and 2,336 (86 percent) were granted after SEDI's launch date, with the majority of awards filed between 2006 and 2010. This distribution is not unexpected given how we defined our sample of companies (companies listed on the TSX as of December 2010) and the volatility of companies listed on the TSX at any point in time. The distribution may also be caused by the fact that stock option awards increased in popularity over our sample period.

[insert Figure 1 here]

6a. Do insiders file the required reports?

We begin by examining the extent of public disclosure. That is, do insiders file the required reports at all? As shown in Table 2, we find that about 9 percent of awards were not disclosed at all. For the OSCB period, we find just over 22 percent were never published in the OSCB. This means that under the old regime almost one-quarter of insider stock option awards were not publicly disclosed until the publication of the issuer's proxy circular. Whether or not the results mean that the insider reports during the OSCB period were not filed as required, a claim we can make for the SEDI period, is not clear without obtaining all insider reports filed with the OSC and comparing them to the reports published in the OSCB. That is, we question the accuracy of the data published in the OSCB. As previously mentioned, the paper filings were first submitted to the OSC, the OSC sent these reports to a third party for data input, that data then had to be transmitted back to the OSC, which then prepared the data for publication in the OSCB. There are many steps where reports could be lost and data not inputted or transmitted. In an effort to determine the degree of accuracy of the OSCB, we obtained copies of the paper filings from the OSC for insider reports for three companies.[28] We cross-checked the paper filings against the OSCB and were surprised to find that a significant portion of the option awards that were duly reported to the OSC by insiders were never published in the OSCB. For the SEDI period, 7.4 percent of awards were never filed.

Figure 2 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. Figure 2 reinforces the summary statistics showing clearly that public disclosure improved dramatically following the implementation of SEDI, which supports the notion that web-based disclosure contributed to achieving the goals of insider disclosure.

[insert Figure 2 here]

While the first six months of SEDI operation saw a surprisingly high number of insider stock option awards not disclosed to the public—over 30 percent—this likely represents a transition problem. Indeed, the percentage of awards not filed on SEDI dropped to 11 percent in 2004, where it remained until 2008 and thereafter the number of reports not filed fell in each subsequent year, to a low of 2.9 percent by 2010. 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 they demonstrate that compliance with the filing requirements may have markedly improved.

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, we obtain data from the Disciplined Persons Database. In that database, we found little evidence of increased enforcement. We find that only seven individuals have been sanctioned for failing to file in PQ since 28 March 2007 and 88 individuals have been sanctioned in BC since February 26, 1991. The punishments range depending on the number of counts of failure to report of which individual is found guilty. Interestingly, in PQ the seven insiders sanctioned for failure to report were found liable only for failure to report; in BC, most of the persons sanctioned for failure to report have also been sanctioned for other breaches.

It might be more fruitful, given our data, to ask what explained the trend in non-compliance. This leads us to two sub-questions: who does not file and is the failure to file habitual? We limit our focus to examining SEDI data (since the OSCB data cannot differentiate between publication errors and non-filers) and find that 135 NEOs, most of whom are VPs, at 58

companies did not file stock option awards on SEDI. Of the 135 people, 80 percent of them only failed to file once and 15 percent only failed to file twice. The awards not disclosed are also dominated by those only given to one or two named executives. Of those awards granted to one NEO, 26% are not disclosed, and of those awarded to two NEOs, 11% are not disclosed.

We estimate a probit model to estimate probability and significance of an award not being disclosed and these results are presented in the first column of Table 3. The results reported in Table 3 match the results from the descriptive statistics. Being a CEO decreases the probability of not filing by 0.03 and a CFO by 0.02. An award to just one NEO increases the probability of not filing by 0.15 and an award to two NEOs increases the probably of not filing by 0.05. Reinforcing the trend observed in Figure 2, every additional year decreases the probability of not filing by 0.01.

[insert Table 3 here]

Table 3 also indicates that an insider's first and second awards have a higher probability of not being disclosed; a first award increases the probability of the award not being reported by 0.16 and a second award has an increased probability of not being reported of 0.07. As shown in Figure 3, more than 67 percent of the awards that were not reported were an insider's first recorded stock option award and reporting improved dramatically for the second award and continued to improve for each subsequent award. This distribution is similar across all years of data, even the most recent years. In addition, awards given to just one or two NEOs are dominated with first awards. This probably 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.[29]

[insert Figure 3 here]

This data suggests that there is a learning curve —or an initial failure to educate— associated with insider reporting obligations. This is corroborated by the fact that nearly a third of those who failed to report their first stock option grant, subsequently filed an opening insider report (which is required to be filed within 10 calendar days of first becoming an insider) within two weeks of the initial (unreported) stock option grant that the opening report includes the number of options from the initial (unreported) stock option grant. Interestingly, in some cases the option award not filed is the insider's last option award at that issuer.

Based on these results, we offer an important caveat about the displayed increase in compliance we report in Figure 2. The reduction in noncompliance observed for the years 2008-2010 could be solely due to sample issues, notably a lack of turnover in the insiders at our 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 our data we see that the proportion of first awards steadily falls from 75% in 2004 to 15% by 2008 where it has remained, providing further support for this hypothesis. This suggests that perhaps the impression first left by Figure 2, that compliance with the filing requirements may have markedly improved, is only partially true. That is, the observed decrease in non-compliance rates starting in 2008 can also be explained by the reduced proportion of first awards in our sample.

The policy recommendations that flow from these results suggest that simply increasing fines and punishments for not filing may not be the most effective avenue for increasing reporting. 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 those awarded shortly before leaving the company. Companies appear to be in the best position to educate their insiders on their reporting requirements, particularly since they know when an insider becomes an insider and when these insiders receive awards. Alternatively or in conjunction with insider education: (1) 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; and (2) companies could be required to issue a public press release on the day of any option grant as is required in the US 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. Finally, perhaps just as insiders must file an opening report, all insiders should be required to file a closing report when they leave a company.

This is not to suggest that there is no room to consider fines and other punishments for those who either chronically or sporadically fail to file. Some individuals are chronic non-filers and more file sporadically. That is, they successfully file at least one insider report and then fail to file an insider report for a subsequent stock option award. Both actions suggest a disregard for the regulations as well as the rationale for insider disclosure. 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 argued that more serious breaches could be minimized if more effective action is 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.

6b. Do insiders file the required reports on time?

Table 2 shows that 27 percent of stock option awards to insiders were not disclosed to the public within the time frames stipulated by securities legislation. During the OSCB period, 98 percent of awards were disclosed to the public after the required filing date. However, this does not mean that 98 percent of insiders filed their reports late because we could determine only when a report was published in the OSCB, not when the report was received by the OSC. Within this reporting regime are two filing regimes as detailed in section three. Prior to December 14, 1999 all insider reports had to be filed within 10 calendar days from the end of the month in which the option was awarded. 4% of all awards were filed under this requirement. From December 14, 1999 all insider reports had to be filed within 10 calendar days and the majority of awards (84%) are filed under this filing requirement. The SEDI reporting period is presented to the right of the dotted vertical line and also within this reporting regime are two filing regimes, the first of which was the same as the last filing regime during the OSCB period. The second one, which started on November 1, 2010, requires insiders to file reports within five calendar days of their option award.

Figure 4 presents the distribution of late disclosures by year and by filing regime. The OSCB reporting period is presented to the left of the dotted vertical line. It is evident that, during the OSCB reporting period, the majority of insider stock option awards were disclosed to the public well after the required disclosure date. Since the advent of SEDI, awards that are not disclosed[30] on a timely basis dropped substantially to 19 percent. Figure 4 shows late filings drop

quickly in the first two years of SEDI, stabilizing around 33 percent in 2005 to 2007. Since 2008, the frequency of late filings has been steadily declining, and continues to fall even under the accelerated five-day filing regime. Again, it appears the move to an online and real time filing regime may have been effective in increasing timely disclosure.

[insert Figure 4 here]

The length of the delay has also improved under SEDI. During the OSCB period, the average publication delay (i.e., the number of days between the required filing date and the actual disclosure date)—77 days— is quite significant. The range is equally interesting. The minimum filing delay is actually negative, meaning that some reports were disclosed in the OSCB before the filing deadline had passed. The maximum filing delay is just over four years (the median delay is 35 days). Under SEDI, the average disclosure delay has been only 6.1 days (the median delay is -3 or three days before the required filing date), ranging from reports filed on the same day as the grant to 5.7 years after the grant. If we focus solely on those reports that were filed late, the average filing delay for late filed reports is 80.4 days, ranging from 1 day late to 5.7 years, with a median delay of 18 days.

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 percent 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." As a result, there is not sufficient evidence to suggest that late fines are driving the observed results.

While the SEDI period shows improvement in the number of reports filed late, there has been little improvement in the disclosure delay of those reports that are filed late. Figure 5 shows the average disclosure delay by year, for all insider reports and for late reports only. Notably, Figure 5 shows that if a report is filed late, it is likely to be filed long after the required filing date and the publication delay actually increased after some provinces began publishing the names of late filers. 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 in section 3, 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 needs to be reconsidered if it is meant to curb late filed reports.

[insert Figure 5 here]

As before, we might uncover more useful policy guidance by considering who files late and how often. Limiting our attention to SEDI data (since the OSCB data cannot differentiate between late publication and late filers), 44 percent of individual insiders across 75 percent of the companies were responsible for the tardy awards, most of whom are VPs and CFOs. The awards filed late are also once again dominated by those only given to one or two NEOs. Of those awards granted to one NEO, 46% are not disclosed, and those awarded to two NEOs, 33% were not disclosed. Of those that filed late, nearly three-quarters of those individuals filed late on one

occasion. A further 17 percent filed late on two occasions while 8 percent who fail to meet any standard of timely filing—i.e., the habitual late-filer— by filing late on three or more occasions. The high number of executives who filed late on only one occasion combined with the high proportion of companies in our sample represented in late filings, indicates that late filing is neither uncommon nor limited to a select group of companies or individuals. That said, we do find that insiders at some companies always file on time, while insiders at a small number of other companies almost always file their reports late. For example, at ten companies, insiders filed their reports late more than 50 percent of the time and in three cases, more than 70 percent of the time. This gives some indication that while insider filings are the responsibility of the individual executive, there appears to be an element of corporate culture associated with the timeliness of filing.

We again estimate a probit model to model the probability of an award being filed late and these results are presented in the second column of Table 3. Being a CEO decreases the probability of filing late by 0.05. An award to just one NEO increases the probability of filing late by 0.23 and an award to two NEOs increases the probably of not filing by 0.04. Reinforcing the trend observed in Figure 2, every additional year decreases the probability of filing late by 0.04. Mirroring the results in section 6a., quite interestingly the results also indicate that an insider's first (0.21), second (0.09), and third (0.07) award each have a higher probability of being late filed, suggesting that it takes longer to become familiar with the rules regarding timely disclosure. As shown in Figure 6, more than 55 percent of the late–filed reports are related to an insider's first recorded stock option award. The proportion of awards filed late drops exponentially for subsequent awards but not as quickly as for reports that are not filed. This

distribution is similar across all years of data, even the most recent years. We again point to our previous caveat: the increasing proportion of awards being filed on time is likely driven in part by sample issues and not due to an overall increase in compliance.[31]

[insert Figure 6 here]

Many of our policy recommendations outlined in section 6a also apply here. Options awarded on a particularly day to multiple insiders are often all reported on the same day, suggesting that an agent (perhaps the reporting issuers) is responsible for reporting. Such multiple reports are less likely to be late-filed. This supports our previous recommendation that the responsibility to file insider reports for stock option grants should rest with the issuing company: "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.

6c. Are insider reports accurate?

Unlike missing or late filings, which are quite simple to identify in our data, an inaccurate report can only be identified by comparing data from multiple sources. For the OSCB period, more than 10 percent, and for the SEDI period nearly 15 percent of insider reports, do not provide the same information as that provided in the proxy circular. In some cases, this reflects a simple omission of information from SEDI. 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 well as to deter improper trading. Incomplete information in filings threatens these goals. Missing information could easily be addressed by a simple change in the SEDI data interface which does not allow a report to be filed with missing information.

In other cases when insider reports and proxy circular data are incompatible, the error may be simply a typo. This includes adding an additional zero to the number of options awarded, transposing numbers, entering the grant date in the expiration date column, or vice versa. While these typos seem innocuous, they can leave investors and the public with the wrong information about the stake an insider has in a company. Entering in the wrong number of options can lead to a misstatement of outstanding options. Entering the grant date for the expiration date leaves the impression that the insider lets options expire unexercised. Entering the expiration date in place of the grant date suggests that the disclosure of the grant award occurred several years after grant, which again leads to erroneous conclusions about the insider's stake in the company at specific points in time. In the case of misidentifying grant and expiration dates, this could again easily be addressed by a simple change to the SEDI data interface. SEDI should not allow an insider to: (1) enter a grant date that is beyond the filing date; or (2) enter a grant date that is past the expiration date. In fact, entering the expiration date incorrectly or failing to provide the expiration is the most common error we found in insider reports.

While the grant date is not required to be reported in the proxy circular, some companies do provide this information. The second most common type of error was the report of a different grant date than that indicated in the proxy circular. 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 some insiders are not informed of their awards in a timely manner by the issuer. 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.[32] Doing so typically ensures that the insider is not reported as being a late filer.

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 that 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 give it the appearance of a performance-based award rather than a compensation-based award. If the insider reports the expiration date of the options correctly, then the grant date can generally be deduces because

options tend to expire within a fixed time after an award is granted (most commonly, five years). However, some companies use a fixed expiration date (e.g. December 31) rather than a fixed expiration term (five years) so using the expiration date is an imperfect method of determining a grant date.

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 UK requires that insiders be notified within two trading days. Since Canadian insiders are currently required to file their insider report within five calendar days of the grant, a two-day the 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 late filed. The simplest solution, however, seems to be one that we repeatedly advocate: require the issuer to file the insider report when a stock option is awarded, as is done in the UK and Australia. National Instrument 55-104 already gives issuers the option to file stock-based compensation reports on behalf of insiders and as we demonstrated previously, 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.

The discovery that some reported grant dates are inaccurate led us to cross-check grant dates in our remaining sample where the grant date was not reported in the proxy circular. To double check grant dates, we obtained stock data for our sample of companies. We located the reported grant date in the stock data and compared the exercise price to the stock price either

using the closing price of the stock on the day before the award or the pricing system outlined in the company's stock plan. We were unable to confirm the grant date for an additional 10 percent of our sample. In cases where the expiration date was provided, we used this information to impute a possible grant date and then compared the price information again but, as discussed previously, information on expiration dates is incomplete and in some cases the expiration date does not match directly to a grant date. Again, it is impossible to ascertain whether apparently incorrect grant dates reflect the reporting of notification dates, the ignorance of executives as to the details of the grant, or the accidental or willful misreporting of information.

As in the cases of late- and non-filing, we wished to consider whether downward trends in improper reporting could be observed over the years. Observation of our sample indicated that this was not in fact the case. Spikes in errors and omissions in reporting occurred over the course of our period of study. This indicates in part that whatever has contributed to the diminishing numbers of late and non-filers has failed to have an impact on incomplete or inaccurate reporting.

The degree to which insider reports are inaccurate or incomplete is surprising. It does reinforce the value of requiring that the expiration date be provided as it provides a quick check on the probable accuracy of the reported grant date. It also reinforces the idea that there should be methods available to deduce the difference between notification dates and grant dates. Moreover, it shows the benefit of requiring that the same information be included in annual proxy circulars and insider reports. For example, requiring the disclosure of a grant date in proxy circulars would alleviate difficulties with exploring the accuracy of reported grant dates on

SEDI. Such a requirement might also encourage more careful reporting as errors would become more apparent to investors and securities regulators.

Awards filed with incomplete or inaccurate information can be difficult to detect and are a threat to the achievement of the stated goals of reporting requirements: market efficiency, investor confidence, and ethical reporting standards. While our analysis of data shows a disturbing upward trend in the occurrence of such improper filing, it is likely that small changes to regulations and reporting software could serve as simple solutions. SEDI could be updated to disallow a user from posting a report with missing or illogical information. This would help lessen the possibility of human error contributing to misleading reports. Also, a requirement to include the grant date in a proxy circular's executive compensation report and the notification date in an insider report would be useful. These two additional requirements would contribute to clarity and may discourage improper reporting.

7. Conclusion

Missing, late, and misleading insider reports have been, and continue to be, roadblocks to achieving the goals of reporting requirements. Table 4 summarizes the findings of our study. The good news is that late and non-filed awards appear to have diminished over time, particularly with the launch of the SEDI reporting system. The bad news is that report with errors and omissions of data have not diminished over time or with the advent of SEDI. Our work demonstrates that it is not possible to determine all the characteristics of filing error (such as the occurrence of missing files) by examining only one information source.

In light of these findings, we propose a number of recommendations. If the onus of reporting is going to remain on the insider – which is not our first choice – there are a number of

things that can improve the timeliness and accuracy of insider reports. First, companies should educate insiders regarding their filing obligations with an emphasis on first and final awards. Second, financial penalties should apply to chronic non-, late, and erroneous filers. The penalties should be structured such that ta maximum cap on penalties 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.[33] Third, many of the errors and omissions might be avoided by simple changes to the SEDI system that prevent the acceptance of reports with obvious errors. We suggest that the SEDI system refuse to accept a report that does not include information in all required fields or that contains a grant date later than the report date. More to the point, though, we recommend that the onus of filing option awards and exercises be placed on the reporting issuer rather than the insider since the reporting issuer has all of the information that must be reported, can report it in a timelier manner, and has a deeper pocket from which to pay penalties for non-compliance. In order to check the accuracy of insider reports (whether filed by the insider or the reporting issuer), we further recommend that the grant date become required information in the executive compensation section of the management proxy circular. Our recommendations can be easily implemented and contribute to investor confidence and market efficiency.

Our results also call into question the effectiveness of a recently added policy rationale for insider reporting in Canada. Namely that

> Insider reporting also helps prevent illegal or otherwise improper activities involving stock options and similar equity-based instruments, including stock option backdating, option repricing, and the opportunistic timing of option grants (spring-loading or bullet-dodging). This is because the requirement for timely disclosure of option grants and public scrutiny of such disclosure will generally limit opportunities for issuers and

> insiders to engage in improper dating practices. (*Insider Reporting Requirements and Exemptions,* Companion Policy 55-104CP [CP 55-104], s. 1.3(2))

The number of insider reports that fail to comply with the disclosure requirements, calls into question the ability of disclosure on its own to curb these illegal and dubious practices. Indeed, the U.S. had far more stringent reporting and enforcement requirements in place, compared to Canada, yet this did not curtail opportunistic timing of options grants in the U.S. Our results suggest that research on opportunistic timing of options grants is long overdue.

Endnotes

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[1] We do not consider in this paper whether or not there should be disclosure rules but note that there is a rich literature in this area. In particular, we do acknowledge that there is a great deal of debate in the academic literature as to whether we should be concerned about insider trading, first discussed by Manne (1966), with no resolution in site. For a recent review of the issues and debate, see Bainbridge (2001). There is also some debate as to whether insider trading laws even achieve their objective. Bris (2005), for example, shows that by prohibiting insider trading, insider trading is made even more profitable and Bhattacharya and Daouk (2009) demonstrate that no securities law is better than a case where the securities law is not enforced.

[2] We use the term "reporting issuer" to refer to a corporation that has issued securities under a prospectus or has its securities listed on a regulated stock exchange. Most securities legislation includes a definition of "reporting issuer."

[3] M&S (2010) indicate that minor penalties for late filing exist in several provinces and that there are no penalties for filing errors. While there is no specific penalty for filing errors, each of the provinces has general penalty provisions that can be applied to misleading reports. See *infra*, section 3.

[4] A number of differences exist between executive and other employee stock options and "standard" stock options. First executive stock options are not traded publicly on an exchange, but rather are a private contract with the board of directors or compensation committee of the firm serving as the writer of the option and the executive acting as the holder of the option. Second, executive stock options provide the executive only the right to purchase the underlying stock, while traditional stock options can be either call or put options, which allow the holder to buy or sell, respectively, the underlying security at a specified price. Third, the executive must typically hold the option for a pre-specified vesting period which is not present in standard stock options. Fourth, executive stock options are normally not transferable and are forfeited if not immediately exercised upon leaving the company. Fifth, standard stock options usually have a terms of less than one year while executive stock options typically have a longer term, and typically five or ten years. Last, executive stock options are usually granted at-the-money, meaning that the exercise price of the option equals the market price of the underlying stock on the day of the option grant, where as a traditional stock option is, of course, issued out-of-the-money.

[5] 100 percent of Canada's largest public corporations have granted stock options to their executives (Klassen 2002, 41). Stock options have become the single largest component of compensation among CEOs at large publicly traded companies in Canada. According to Mackenzie (2012, 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.

[6] Recent cases have raised concerns about stock options, including the practices of (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.

[7] As Armstrong (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."

[8] 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 USA 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.

[9] 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.

[10] Screen shots of the information that must be filed by an insider following a stock option award can be seen in CSA (2008, 193-196).

[11] Insiders must also provide their closing balance. 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 balanced reported on SEDI will be incorrect.

[12] Under the previous regime, some insiders had up to 41 days within which to file a report whereas others would only have 10 days. Since some insiders were expected to report within 10 calendar days, it was deemed that all insiders should file within this window. However, many were still concerned with this window, arguing that it should be shortened.

[13] 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.

[14] But usually long after the initial filing. See discussion in section 6b.

[15] For example, Ontario Regulation 101/67 item 6 required disclosure of "aggregate direct remuneration paid or payable by the corporation and its subsidiaries ... to the directors and the senior offers of the corporation ... and as a separate amount the aggregate remuneration paid or payable to such directors and senior offices by subsidiaries."

[16] Ontario Regulation 638/93 amended Form 30 (then the form for the proxy circular, originally introduced in 1979 (Ontario Regulation 478/79)) and required the completion and attachment of Form 40 "Statement of Executive Compensation" (see Item 6 on Form 30).

[17] From *Continuous Disclosure Obligations,* NI 51-102, s. 1.3: "Named Executive Officer" or "NEO" means any of the following individuals:

(a) each CEO who served in that capacity for any part of the most recently completed fiscal year;

(b) each CFO who served in that capacity for any part of the most recently completed fiscal year;

(c) each of the company's three most highly compensated executive officers, other than the CEO and CFO, who were serving as executive officers at the end of the most recently completed fiscal year and whose total compensation exceeded $150,000; and

(d) any other individuals for whom disclosure would have been provided under (c), except that the individual was not serving as an officer of the company at the end of the most recently completed fiscal year.

[18] Development of SEDAR began in 1990 with inspiration from a similar program in the US called the Electronic Data Gathering and Retrieval system (EDGAR).

[19] The Canadian Depository for Securities Limiter is responsible for the continued operation of SEDAR (Gillan, 1998, 205-207).

[20] Due to the sensitive nature of this research, we do not disclose the companies, sector, or jurisdictions from which the companies were selected.

[21] We omitted 2011 option awards as the proxy filing period for that calendar year was not completed at the time of data collection.

[22] As per the SEDAR Filer Manual (CSA 2010, 53-54), prior to September 1999 issuers were allowed to submit documents in Word, WordPerfect, or PDF formats. Since then, only PDF documents are allowed.

[23] We chose to restrict our attention to plain vanilla stock option awards which represents the majority of stock option awards.

[24] We eliminate income trusts 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.

[25] The cost for each company includes a $150 purchase fee and copying costs of 50 cents per page. To obtain insider reports for our 106 companies, the company fee alone (i.e., not including photocopy charges) would have been approximately $16,000.

[26] The digital data on the OSCB publication of insider reports for the pre-SEDI period was obtained from the OSC at a cost of $169.50.

[27] For discussions related to backdating in Canada, see Compton, Sandler, and Tedds(2009, 2010); and Compton, Nicholls, Sandler, and Tedds (2011, 2012).

[28] The insider reports for these three companies cost of over $600.

[29] We re-estimate our probability model and include an interaction effect between the indicator for an award going to one NEO and the award being the insider's first award. We obtain the marginal effect of this interaction using the methodology suggested by Ai and Norton (2003) and find that a first award to one NEO increases the probability of an award not being filed by 0.2.

[30] Under the SEDI regime, public disclosure and filing date coincide so these words are used interchangeably.

[31] We re-estimate our probability model and include an interaction effect between the indicator for an award going to one NEO and the award being the insider's first award. We obtain the marginal effect of this interaction using the methodology suggested by Ai and Norton (2003) and find that a first award to one NEO increases the probability of an award being filed late by 0.22.

[32] As noted in section 3, the grant date of an award is that date when the legal steps necessary to authorize the issue of the options (including any 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 in one of two ways: with a grant date or without a grant date. If the notice has a grant date on it then the officer must file the insider report within ten 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.

[33] 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).

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Table 1: Summary of data sources and information contained within each data source

Data Source	TSX	SEDAR	OSC	SEDI*	CFMRC/Yahoo Finance
Obtained	www.tmxmoney.com/en/sector_profiles/index.html	www.sedar.com	Purchased from the OSC	www.sedi.ca	http://dc1.chass.utoronto.ca/cfmrc/subscribers.htm www.ca.finance.yahoo.com
Document Type	XLS spreadsheet Public Download	Annual Proxy Circular (.pdf or .doc)	OSC Bulletin Insider Reports in .cvs format	Public Download	Subscriber Download Public Download
Time Period	Companies listed as of December 31, 2010	1996-2011	1996-June 2003	June 2003-2011	1996-2011
Data Available	Issuer Name	Issuer Name	Issuer Name	Issuer Name	Issuer Name
	Issuer TSX Ticker		Issuer TSX Ticker[†]		Issuer TSX Ticker
	Province of Headquarter location		Province of Headquarter location		
	Date of TSX listing				
		Insider Name	Insider Name	Insider Name	
		Insider Position[‡]		Insider Position	
		Annual Salary[§]			
		Annual Bonus			
			Transaction Type (original or amendment)	Transaction Type (original or amendment)	
			Transaction ID	Transaction ID	
		Grant date (some)[@]	Grant Date	Grant Date	

			Publication Volume[£]		
				Insider Report Filing Date (also the publication date)	
		Number of Stock Options Issued	Number of Stock Options Issued	Number of Stock Options Issued	
		Exercise Price	Exercise Price	Exercise Price	
				Balance of Options	
		Expiration date		Expiration date	
		Market price (some)	Market price (some)		Market price

Author's compilation

Notes

* The data was obtained by going to sedi.ca, clicking on Access public filings, selecting View summary reports, entering the issuer name, and selecting Options. This provides us with all filings related to stock options for a given issuer. Insiders can amend their reports if they provide incorrect information in their original filing. In cases were an amendment was filed, we use the original filing date combined with the amended filing information. Most amendments are for number of options granted and expiration dates of the options. Some amendments change the grant date and exercise price. For these types of changes, we carefully cross-check the information.

[†] We did not use the ticker symbol provided in the OSCB data because they did not match those from the TSX or CFRMC.

[‡] We narrowly define this variable as either the Chief Executive or Chief Operating Officer, the Chief Financial Officer, or a Vice-President or other senior officer of the issuer.

[§] Annual salary and bonus data were converted to real terms (2002 dollars) using the Consumer Price Index (Cansim Series Number V41693271).

[@] For some stock option awards we have information on the grant date and the price at which the company's stock was trading upon issuance of the stock option award.

[£] We obtain the publication date by matching the publication volume to the publication date for that volume.

Table 2: Summary Statistics

Variable	Mean	Standard Deviation	Minimum	Maximum	Sample Size
Sample Size					2716
Number of Executives					723
Number of Companies					106
Salary ($2002)*	237139	218093	0	5540000	2072
Bonus ($2002)	251414	469173	0	9920000	2072
Number of Options per award	153810	365089	1875	7500000	2716
Value of award ($)	1280000	3010000	5000	87500000	2712
Year	2007	3.20	1996	2010	2716
CEO	0.29	0.45	0	1	2716
CFO	0.22	0.41	0	1	2716
VP	0.49	0.50	0	1	2716
Grant made to: One NEO	0.10	0.29	0	1	2716
Grant made to: Two NEOs	0.060	0.24	0	1	2716
Grant made to: Three NEOs	0.13	0.33	0	1	2716
Grant made to: Four NEOs	0.19	0.40	0	1	2716
Grant made to: Five or More NEOs	0.52	0.50	0	1	2716
Grant awarded during OSCB period	0.14	0.35	0	1	2716
Grant awarded during SEDI period	0.86	0.35	0	1	2716
Results related to section 6a.					
Not Disclosed under either regime (A & B)	0.090	0.29	0	1	2716
Not published in OSCB (A)	0.22	0.42	0	1	380
Not filed on SEDI (B)	0.074	0.26	0	1	2336
Results related to section 6b.					
Late Disclosed under either regime (C & D)	0.27	0.44	0	1	2716

Late Published in OSCB (C)	0.98	0.14	0	1	296
Late Filed on SEDI (D)	0.19	0.39	0	1	2336
Filing Requirement: 10 calendar days from month end	0.040	0.19	0	1	2716
Filing Requirement: 10 calendar days from grant	0.84	0.36	0	1	2716
Filing Requirement: 5 Calendar days from grant	0.12	0.32	0	1	2716
Publication delay OSCB (median: 35 days)	77.54	168.18	-5	1473	296
Publication delay OSCB for late published reports only (median: 35 days)	79.19	169.53	1	1473	296
Filing delay SEDI (median: 6.1 days)	6.13	70.61	-10	2098	2163
Filing delay SEDI for late disclosed reports only (median: 18 days)	80.36	183.96	1	2098	2163

Author's compilation

Notes

* In years were an insider receives more than one stock option award, the information on salary and bonus information is blank to ensure appropriate calculation of summary statistics related to salary and bonus information. This is why the sample size is smaller for these two variables.

Table 3: Probit Results

VARIABLES	(1) Awards Not Disclosed	(2) Awards Filed Late
CEO	-0.030***	-0.054***
	(0.002)	(0.002)
CFO	-0.024**	-0.027
	(0.012)	(0.149)
Award to one NEO	0.154***	0.236***
	(0.000)	(0.000)
Award to two NEOs	0.048**	0.136***
	(0.020)	(0.000)
Award to Three NEOs	0.018	-0.012
	(0.251)	(0.633)
Award to Four NEOs	0.004	0.011
	(0.749)	(0.603)
Year	-0.008***	-0.039***
	(0.001)	(0.000)
First Award	0.113***	0.208***
	(0.000)	(0.000)
Second Award	0.033*	0.093***
	(0.077)	(0.002)
Third Award	0.017	0.070**
	(0.374)	(0.027)
Fourth Award	-0.006	-0.001
	(0.776)	(0.971)
Last Award	0.015	0.025
	(0.149)	(0.194)
Awards filed on same day		-0.006
		(0.440)
Observations	2,336	2,336
Pseudo R-squared	0.177	0.171

Notes:
Author's compilation.
*** p<0.01, ** p<0.05, * p<0.1.
Marginal effects reported which are for discrete change of dummy variable from 0 to 1.
Pvalues in parentheses.
Omitted categories: VP, Award to five or more NEOs, Fifth and subsequent awards.

Table 4: Summary of Questions, Findings, and Recommendations

Question	Key Findings	Recommendations
Do Insiders File the Required Reports?	Majority do and reporting has improved significantly since SEDI. Missing reports account for up to 1/10 of all insider reports. Majority of reports not filed are an insider's first award or last award. Small minority of insider are chronic non-filers.	Need for increased clarity regarding insider's obligations. Companies should be encouraged to educate their insiders on their reporting obligations. Companies should file reports on behalf of their insiders. A press release should be issued on the day of each option grant. Insiders should file a closing report upon leaving their position. Fines and other punishments should be enforced for chronic non-filers, who can be identified through regular comparisons of SEDAR and SEDI reports.
Do Insiders File the Required Reports On Time?	On time filings have improved dramatically since SEDI. Late filings account for up to 1/3 of all insider reports. Timeliness of late reports has shown no improvement. Majority of reports that are filed late are an insider's first award. Evidence of corporate culture in late filing. Awards that are filed by a designated agent are far less likely to be filed late.	Calculation of the late fee needs to be considered and cap raised, modified, or removed. Companies should be encouraged to educate their insiders on their reporting obligations. Companies should file reports on behalf of their insiders. A press release should be issued on the day of each option grant.
Are Insider Reports Accurate?	At least 15% and as many as 25% of insider reports are inaccurate. Inaccuracies worsened with SEDI. Some inaccuracies appear to be typos and data entry errors. Incorrect grant date is a common error.	Modify SEDI system so that: 1. reports cannot be filed with missing information. 2. a grant date cannot be entered that is beyond the filing date or the expiration date; 3. notification date of the option is required.

		Require companies to inform insiders of a stock option awards in a timely manner (e.g., two calendar days). Companies should file reports on behalf of their insiders. Require the grant date to be published in proxy report.

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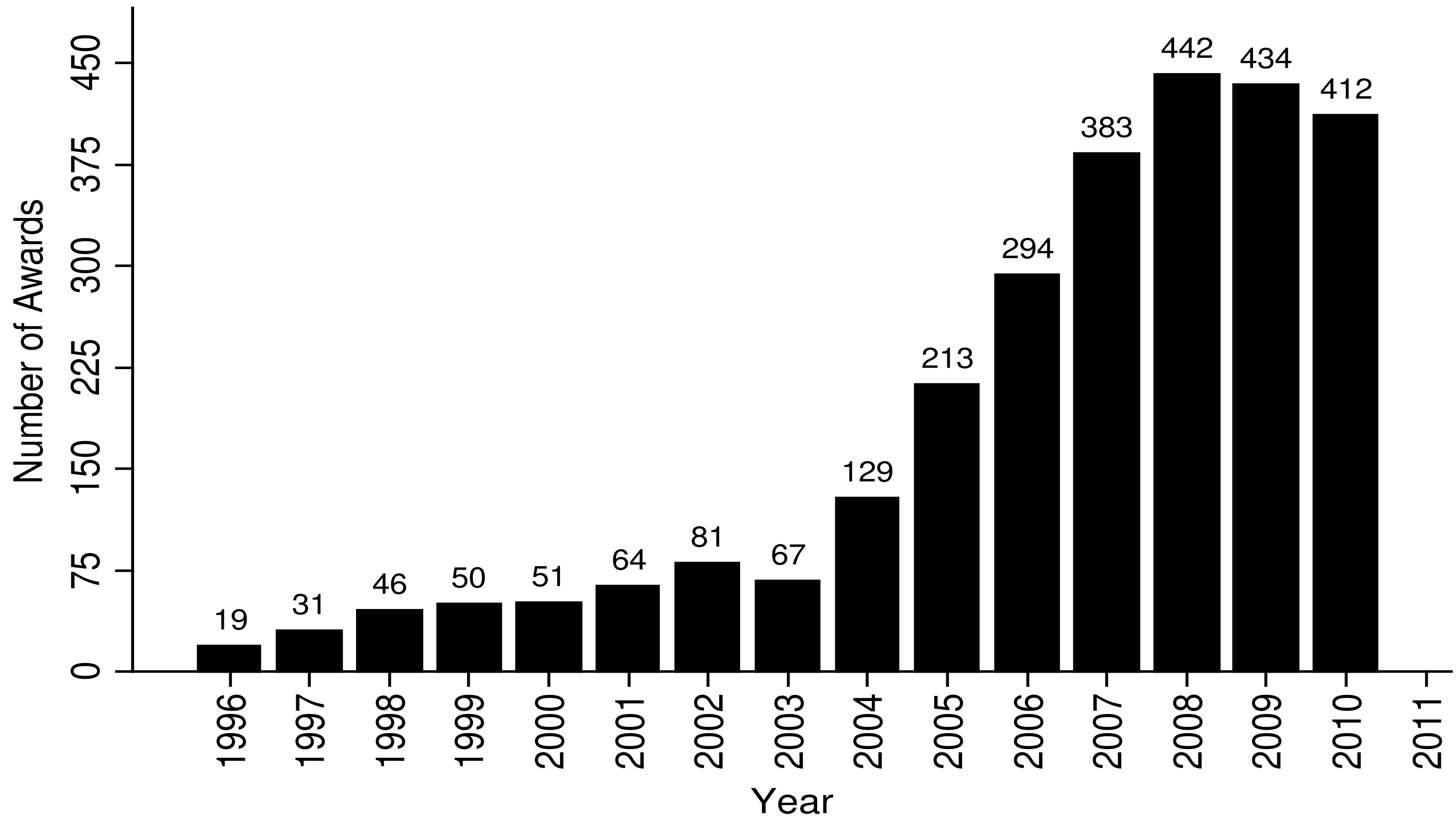

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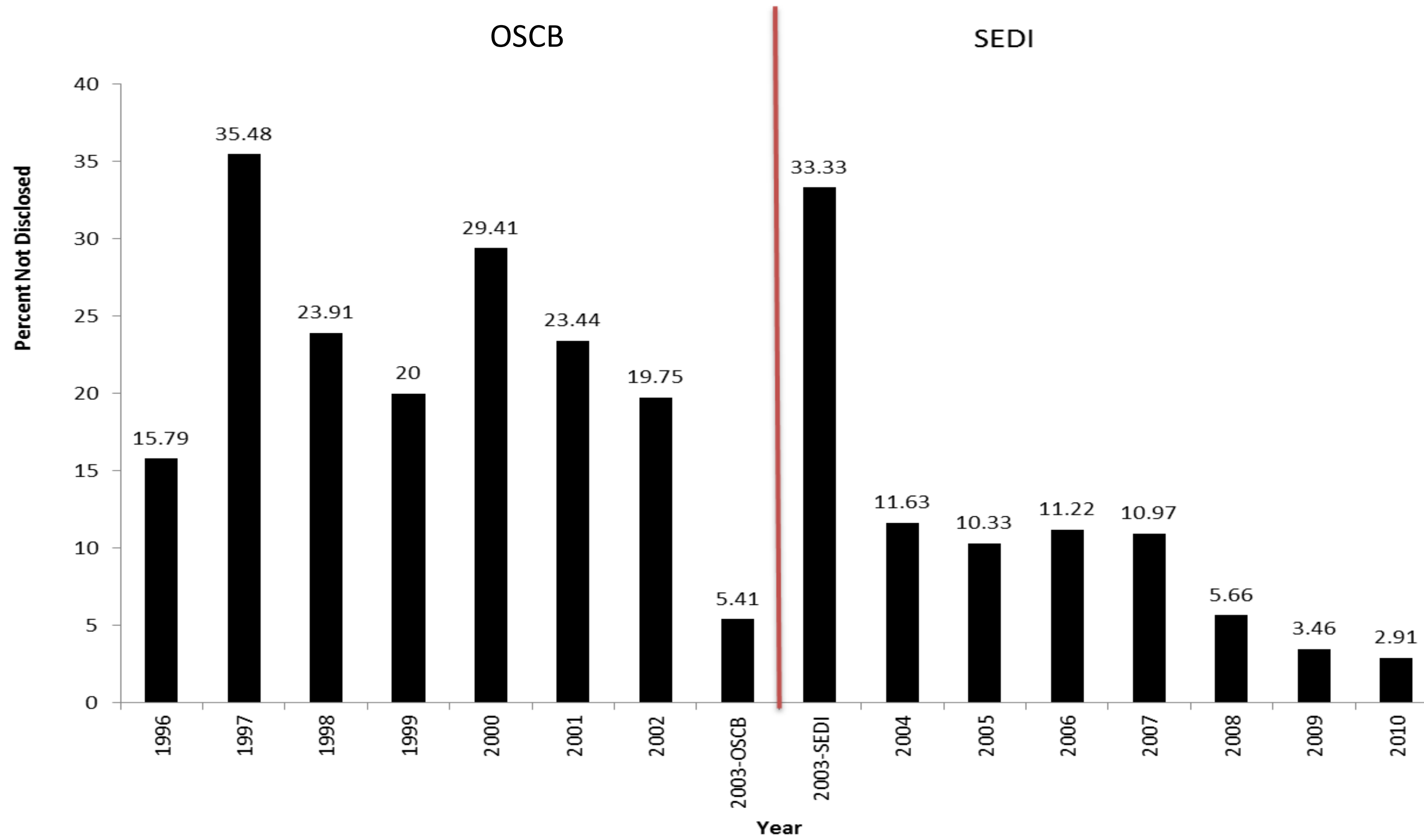
Figure 2: Distribution of the Frequency of Awards Not Disclosed by year 1996-2010



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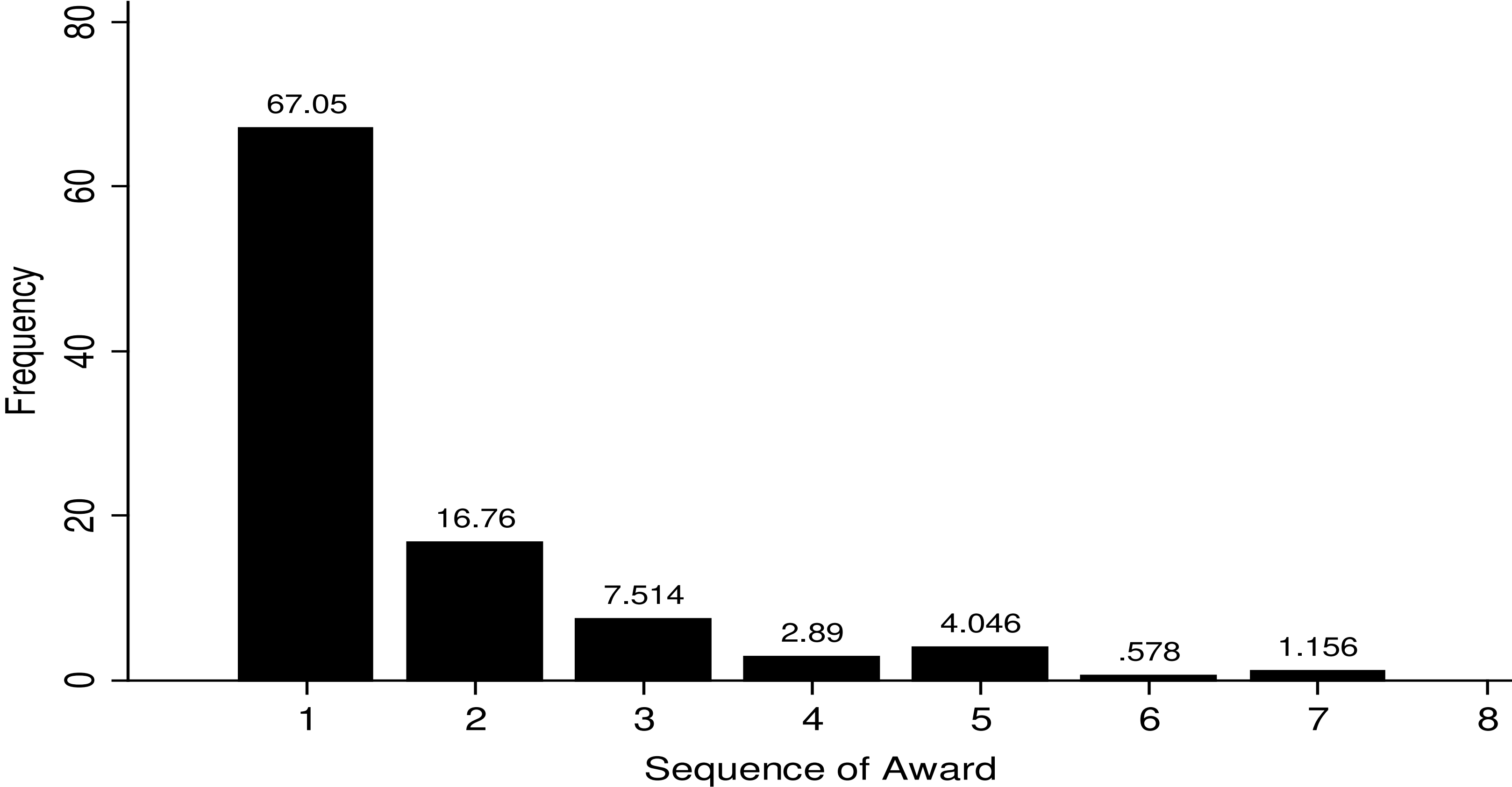

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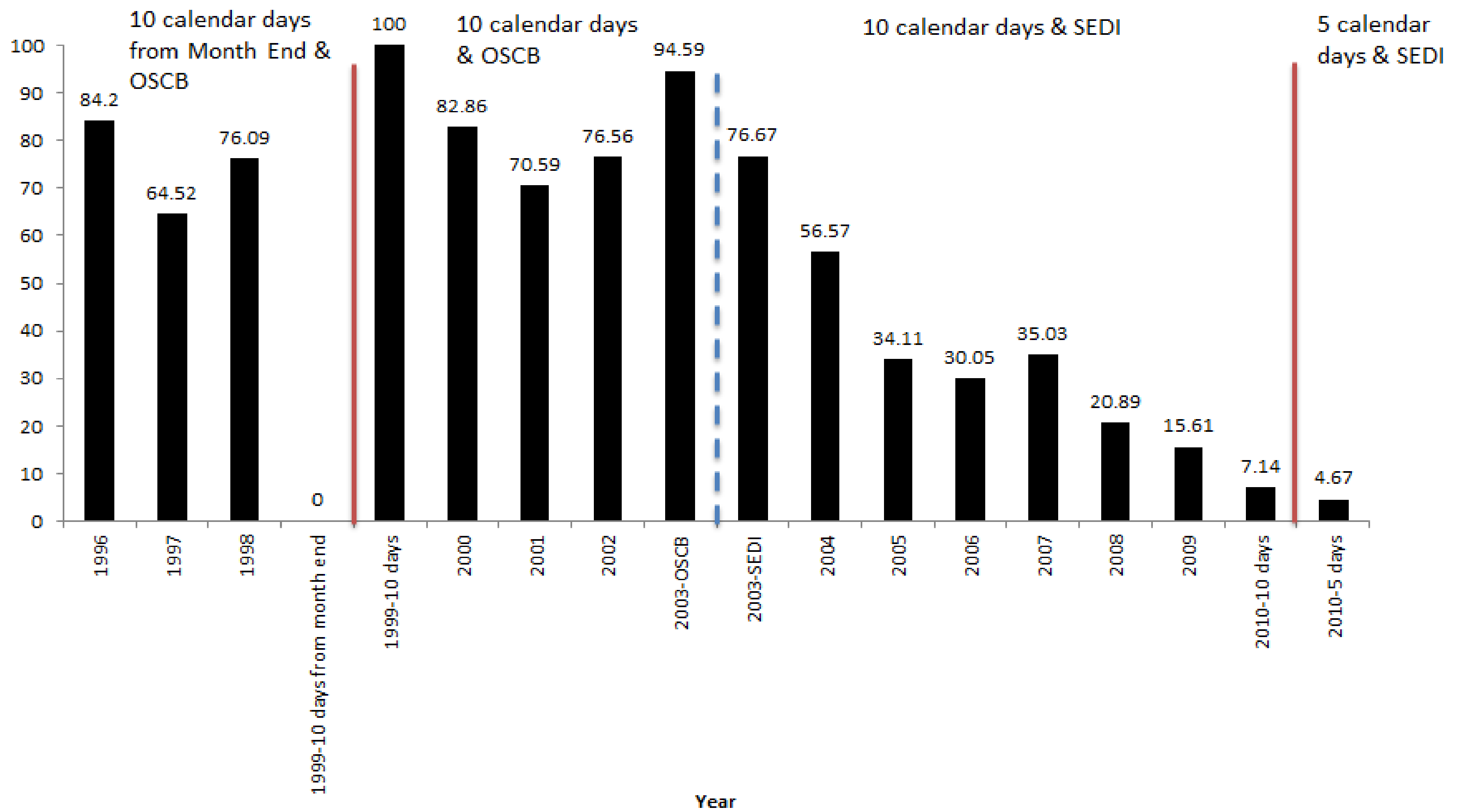

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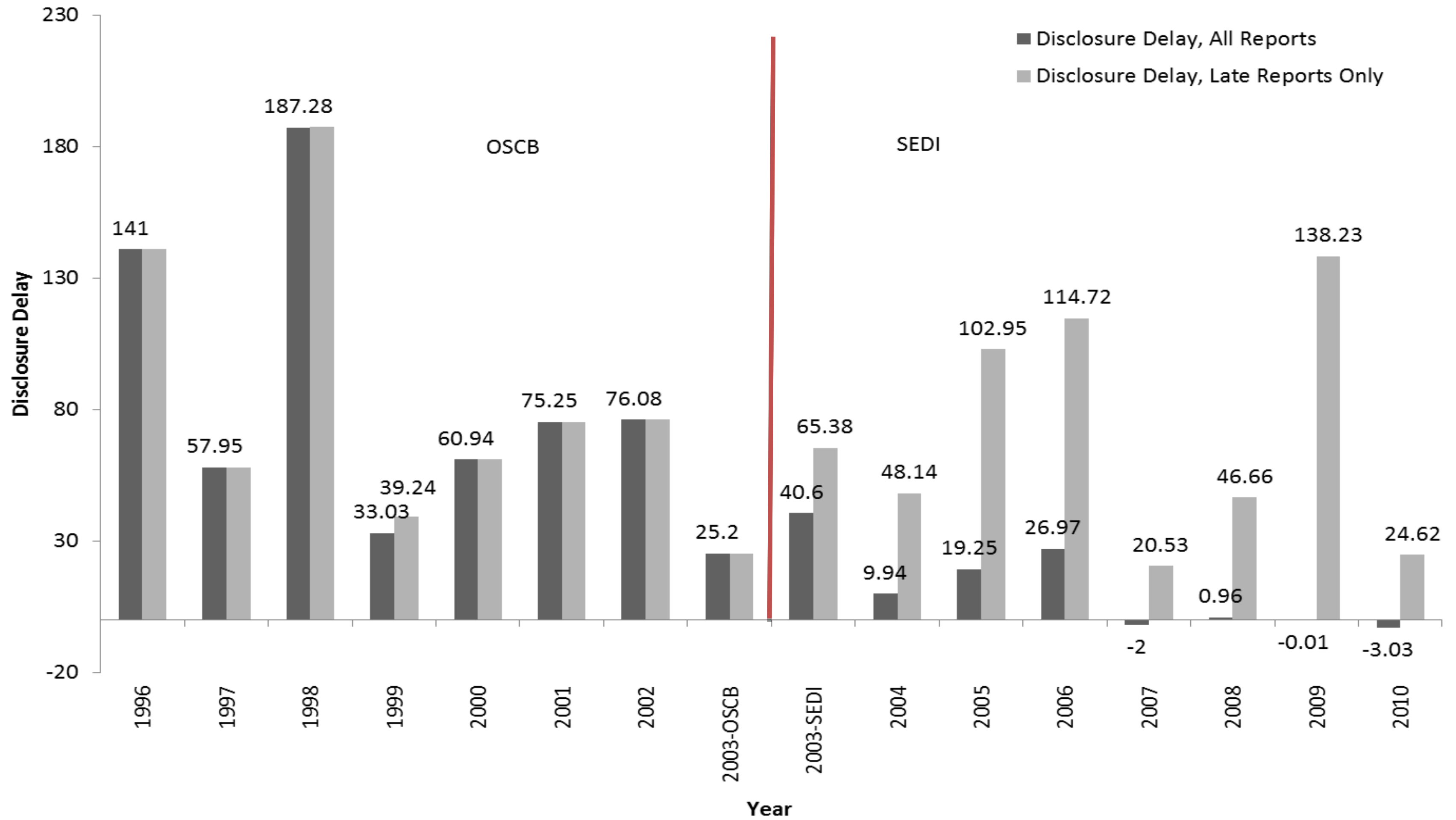

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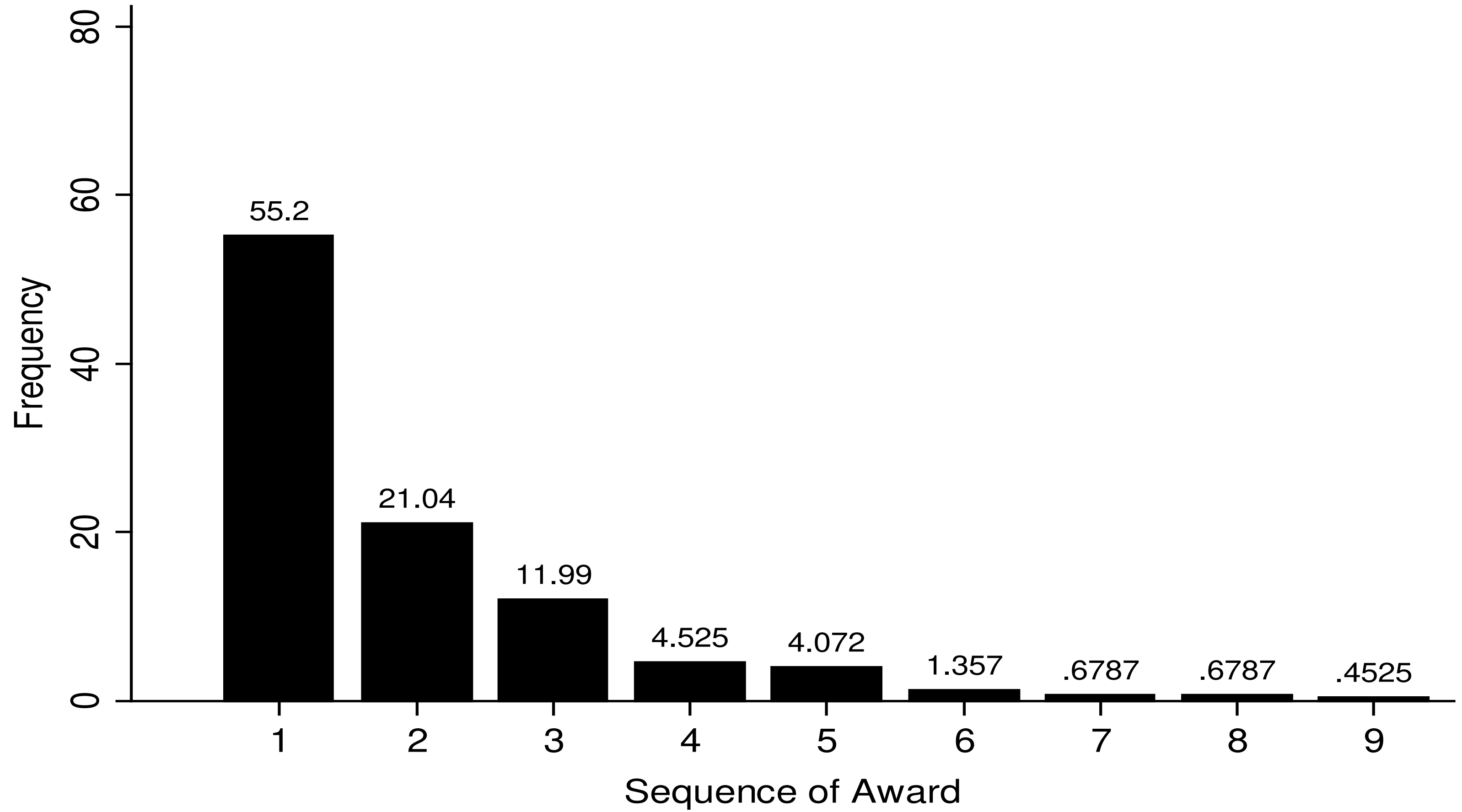

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