

June 16, 2009

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Nova Scotia Securities Commission
New Brunswick Securities Commission
Office of the Attorney General, Prince Edward Island
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Government of Yukon
Registrar of Securities, Dept. of Justice, Govt. of the Northwest Territories
Registrar of Securities, Legal Registries Division, Dept. of Justice, Govt. of Nunavat

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Dear Sirs and Mesdames:

Proposed NI 55-104 Insider Reporting Requirements and Exemptions

1 BACKGROUND/INTRODUCTION

We are finance professors at the School of Business and Economics, Wilfrid Laurier University in Waterloo, Ontario. Since 2001, we have been actively researching the quality and market impact of insider trading reporting in Canada. As part of this work, we have undertaken a comprehensive analysis of all insider reports filed through Micromedia since 1987 and SEDI since inception up to December 2006. Our published articles and relevant working papers are

included in the references. To support this on-going research effort, we have received approximately \$300,000 in academic funding from the federal and Ontario governments.

We appreciate the opportunity to contribute to the discussion of the proposed changes to the rules regarding reporting of insider trading and in particular, the reporting of normal course issuer bid (NCIB) purchases. We discuss two goals of reporting rules and present recommendations designed to better achieve these goals.

2 PROTECT INVESTORS FROM INFORMED INSIDERS THROUGH DISCLOSURE

2.1 Rationale

Insiders are regulated mainly to protect the investing public. The concern is that insiders have asymmetric information about their company which allows them to profit from trading with the public. To protect public investors, insiders are prohibited from trading with undisclosed material information and are required to report their trades to the Securities regulators. Part of the reason for making insiders disclose their trades is to allow regulators (and public investors) to assess whether the insiders traded with such undisclosed information.

2.2 If it walks like a duck...

If companies engaging in NCIBs are like informed insiders then they should be regulated like insiders. In other words, if companies can use their asymmetric knowledge about their company to buy back shares below fair value, then NCIBs will cause a transfer of wealth from shareholders who sell to shareholders who do not sell. Thus, NCIBs can be just as harmful to outside investors as any insider purchase. The questions are: 1) are NCIBs like insider trades; and 2) can companies take advantage of their asymmetric information and cause harm to public investors?

NCIB purchases are controlled by insiders. Insiders (e.g. CFOs) control the decision of when and under what conditions NCIB purchases are made. Thus the decision-maker in an NCIB is the same as a decision-maker in an insider trade.

As first noted in Barclay and Smith (1988), through NCIB purchases, corporate executives are in a position to use their insider knowledge to repurchase shares when they are undervalued. In so doing, they will transfer wealth from selling to non-selling shareholders, including themselves.

Many companies admit to this motive in the press releases announcing their repurchases. For example, Canada News Wire carried the following press release from the Mullen Group Ltd. on June 11, 2009.

The Company has commenced the normal course issuer bid because it believes that, from time to time, the market price of its securities will not properly reflect the underlying, intrinsic value of Mullen, and that, at such times, the purchase of common shares for cancellation will increase the proportionate interest of, and be advantageous to, all remaining shareholders.

Research studies of NCIB purchases indicate that repurchasing companies are just as informed as other insiders and take advantage of this information in their purchases. Brockman and Chung (2001), Cook, Krigman and Leach (2004), McNally and Smith (2007) show that companies on the Hong Kong, New York and Toronto Stock Exchanges respectively repurchase their own shares: 1) when their share prices are lowest during the year—about 7% lower than during the rest of the year; 2) show the same timing ability as executives and board members; 3) earn abnormal returns of approximately 3% on their repurchases i.e. the companies aren't just good at timing the whole market, they also know when their companies are undervalued.

2.3 Recommendation

NCIB purchases should be treated as insider purchases for reporting purposes. Specifically:

- a) The definition of insiders in the relevant Securities Acts should be changed to unambiguously define corporations who are engaged in NCIBs as insiders regardless of whether they continue to “hold” the securities.
- b) Corporations engaged in NCIBs should not be exempt from any insider trading reporting rules.

3 IMPROVE MARKET EFFICIENCY THROUGH TIMELY DISCLOSURE

3.1 Rationale

A second reason for requiring disclosure from companies about NCIBs is to inform shareholders about the company's actions in a timely manner. This information is valuable to investors and so will promote market efficiency.

For many Canadian companies, NCIBs are not being reported to securities commissions on a timely basis. Current rules lead to various levels of disclosure across companies. Some companies report their repurchases within 10 days of the trade, some disclose trades 10 days following the end of the month of the trade and many don't disclose their repurchase trades at all. See McNally and Smith (2003).

A second aspect of timely reporting is to have a system whereby investors can easily track the repurchasing activity of a company. Currently, investors need to go to multiple sources—SEDI, the TSX Daily Record and SEDAR—to get information about repurchases. A uniform system of disclosure of NCIBs through a single source like SEDI would promote greater market efficiency.

3.2 Timely Disclosure of NCIBs is Valuable to the Market

Academic research shows that repurchases convey information to the market. Li and McNally (2007) show that NCIB program announcements convey information to the market. McNally and Smith (2006) find Canadian companies repurchase shares on short-term price dips, so release of information about repurchase trades should be made in a timely manner.

The dominant source of information for both institutional and individual investors has become web-based news providers such as Bloomberg, Google Finance and Globeinvestor. In this environment, investors expect “real-time” disclosure of corporate information. As shown in McNally and Smith (2009) SEDI has greatly improved the accuracy and timeliness of insider

trading disclosure. However, despite the Commissions' efforts at assigning late fees, many reports are still inaccurate and late.

3.3 Recommendations

As a means to improve both timeliness and accuracy, we propose that all insider transactions, including NCIB purchases, be reported immediately after the trade. This can be done for insider purchases and sales on the Toronto Stock Exchange because a system for automatic tracking of these transactions is already in place. That is, insider trades are already flagged on the STAMP system (these flagged trades are monitored by the Market Surveillance team of IIROC). Insiders would continue to be responsible for declaring their insider role to their broker and their broker would continue to be responsible for identifying any orders from these insiders to the exchange. We expect the level of accuracy of the reported pricing and timing of these transactions is nearly 100%. This is because errors in the TSX reporting system will cost one trader real money and this cost serves as a natural check on any errors. A similar reporting requirement must also be imposed on the Alternative Trading Systems (ATS), their member brokers and clients.

If this recommendation were implemented, then there would be no need for companies to report their repurchases to the TSX. This will benefit reporting issuers, as they will only have to report to one agency and, with this system, the reporting is automatic—little effort is required by the company or its broker. Another benefit is that the data quality will be complete and detailed. Currently the repurchase data reported in the TSX Daily Record is more complete than data reported in SEDI (See McNally and Smith (2003)). This proposal will make the data reported to SEDI complete. In addition, the data reported in SEDI is richer than that reported in the TSX Daily Record. SEDI includes dates of repurchases, prices and quantities, whereas the Record only reports monthly totals of shares repurchased.

Regards,

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