EVALUATION REPORT: COMPLIANCE STRATEGIES

FOR THE

CANADA BUSINESS CORPORATIONS ACT

Program Evaluation Division
Strategic Planning and Corporate
Services Branch
July 14, 1992

EVALUATION

OF THE

COMPLIANCE STRATEGIES
FOR THE
CANADA BUSINESS CORPORATIONS ACT

PROGRAM EVALUATION DIVISION
STRATEGIC PLANNING AND CORPORATE SERVICES BRANCH

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We would also like to thank members of LRD for their comments on draft recommendations and a member of Legal Services Branch for a reference regarding victims' redress.

EXECUTIVE SUMMARY

I Purpose

The evaluation concerns compliance and information distribution strategies of the Corporations Directorate in the administration of the Canada Business Corporations Act (1975) (CBCA). The Act regulates the creation and existence of federally incorporated business corporations with a view, inter alia, to protecting shareholders and others connected with corporations.

The purpose of the evaluation is to examine the effectiveness of present and alternative compliance and information approaches, and recommend improvements where possible. Information and compliance were included in the same evaluation because of the program managers' interest and because both private and government enforcement cannot take place without information on individual corporations.

II Methodology

The methods used were: review of the legislation; review of program documents; telephone survey of clients of the program; review of compliance literature; interviews with program staff; interviews with Canadian and foreign experts; case studies; and a focus group.

III Findings

The present compliance strategy includes the following elements: rules; information activities; reminders; monitoring; obtaining voluntary compliance[1]; investigations; warning letters; dissolutions; civil suits; and prosecutions. Some elements have not been used very extensively.

Surveyed clients[2] of the program believe that the requirements of the Act are being well met; however, they perceive non-compliance to be more of a problem in the areas of corporate treatment of shareholders, insider trading, the submission of

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1. Voluntary compliance may sometimes be obtained by bringing non-compliance to the attention of the non-complier.

2. These include: lawyers, chartered accountants, loan officers, representatives of publicly held corporations, representatives of closely held corporations, market professionals and minority shareholders of closely held firms.

annual returns[3], shareholder information and meetings and the quality of financial statements than in other areas[4]. Lack of knowledge and understanding of CBCA requirements was the main reason given for non-compliance, especially for closely held firms.[5] Clients rated the effectiveness of certain Directorate activities presently used to encourage compliance. The average rating for all of these activities was between neutral and effective[6]. Almost half of those finding prosecutions or investigations ineffective suggested that this is because more are needed.

Of six potential Directorate activities for improving compliance in the future, respondents rated as effective: publicizing the names of convicted firms; providing advice to corporations about compliance; education on CBCA requirements; and publicizing a compliance policy on Directorate intervention. They rated as less effective increasing the size of fines and providing performance standards.

Private enforcement (as opposed to enforcement by government) and shareholders' self-protection[7] are not perceived to be working well. Survey respondents and experts supported clarifying the law regarding shareholders' redress and an awareness program regarding shareholders' rights and recourses as means to deal with this problem.

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3. The purpose of these returns is to maintain up to date information on corporate addresses, telephone numbers, financial year ends, types of business, dates of most recent annual meetings and whether there have been changes in directors, registered offices, size classifications and classification as a distributing(publicly held) corporation.

The purpose of collecting financial statements is to ensure that they are prepared and available for interested shareholders, investors and researchers.

4. Other compliance areas of the Act categorized for analysis include: directors' duties and responsibilities; trustees' activities; proxy circulars; takeover bids; liquidation behaviour; disclosure of basic or identifying information; financial structuring; and formulation and submission of articles.

5. Closely held firms were defined by the survey questionnaire to be those that were not publicly traded.

6. This is not to say that every respondent rated the activities the same way.

7. By bargaining between affected parties, shareholders meetings and/or proxy votes and court proceedings brought by shareholders.

Most survey respondents were satisfied with the information about corporations provided by the Directorate; however, insider trading reports received relatively low ratings for timeliness and completeness. Frequent suggestions for general improvements were: increase awareness of information availability; increase access to information; and make the information easier to understand and more complete.

1.0 INTRODUCTION

1.1 Choosing the Evaluation Topic

As a result of an evaluation assessment, two evaluation options were developed and presented. A study of information needs was the first evaluation option. Its major issue was whether the Canada Business Corporations Act (CBCA) required more information to be collected than necessary to achieve the objectives of the Act. The second option addressed the concern of program managers about whether the policy of relying on private enforcement was working. Private enforcement, also called "self enforcement", means that the private sector enforces those parts of the Act related to shareholder protection.

There is considerable interest in compliance strategies for federal laws. We therefore enlarged the scope of the second evaluation option from an examination of the compliance strategy using private enforcement to an examination of the program's total approach to compliance. While the ADM of the program chose the compliance study, the final study design still included some review of information needs. The connection between these two subjects is that information is needed for shareholder protection and for both private and government enforcement of the Act.

1.2 Purpose of the Evaluation

In summary, the purpose of the evaluation is to examine the effectiveness of present and alternative compliance and information approaches and recommend improvements where feasible.

1.3 Outline of the Study

The contents of the remainder of the study are as follows. Section 2 describes the approach and methodology. Section 3 provides a description of the CBCA administration program as a whole and its compliance approaches in particular. Section 4 presents a summary of the findings of the evaluation.

2.0 APPROACH AND METHODOLOGY

2.1 Types of methodologies

The evaluation gathered information concerning clients' and experts' perceptions[8] of: the amount and type of non-compliance; the effectiveness of various compliance tools used by the program, including private enforcement; reasons for any perceived ineffectiveness; the expected effectiveness of specified additional tools; and any suggestions for alternative approaches. It also gathered data on information used, present sources and preferred sources.

The methods used were:

a) review of the legislation;
b) program document review;
c) telephone survey of the clients of the program;
d) review of compliance literature;
e) interviews with program staff and with Canadian and foreign experts in the subject;
f) case studies; and
g) a focus group.

Some of these methodologies do not require further elaboration. The rest follow.

2.1.1 Review of the Legislation

The legislation was reviewed to determine compliance requirements and to understand the enforcement powers of the Director[9] under the Act.

2.1.2 Program Document Review

Program documents were reviewed to help develop the material to describe the operation of the compliance strategies of the program at the time of the study.

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8. The use of perceptions is appropriate because the extent of some types of non-compliance cannot be documented and because perceptions of compliance can be an important component of investor confidence.

9. "Director" with a capital "D" refers to the Director under the Act. Nowadays, this term usually implies the Director General of the Corporations Directorate. At the time of data collection, the program administration was called a "Branch" and the Director under the Act was the Director of the Corporations Branch.

2.1.3 The Telephone Survey

The survey examined both compliance and information issues. It included 517 interviews, divided among the following groups of program clients.

Client Type	Number in Group
Lawyers	103
Chartered Accountants	60
Loan Officers	47
Representatives of Publicly Held Corporations	59
Representatives of Closely Held Corporations	124
Market Professionals (such as stockbrokers, fund managers)	60
Minority Shareholders of Closely Held Companies	64

In the case of corporations, interviewers screened the persons contacted by telephone to ensure that the respondent/representative, was the person in the organization who was most responsible for compliance. Because of the difficulty associated with obtaining a list of members of the general public who are minority shareholders, directors[10] of closely held corporations were interviewed. For this subgroup, a screening questionnaire was employed to disqualify majority shareholders so that only minority shareholders were interviewed.

The sample list was developed employing a variety of sources, including the Consumer and Corporate Affairs data set, various business directories and city telephone directories.

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10. This type of client was less likely to see compliance problems but was an interesting source of perceptions about branch activities, awareness, effectiveness and potential effectiveness.

2.1.4 Interviews

Program staff were interviewed by a consultant at least twice: once, to learn about present compliance strategies and a second time, to learn about compliance strategy problems and opportunities. The second type of interview was undertaken with outside experts as well. The outside experts represented the following organizations:

Companies Branch
Ontario Ministry of Consumer
and Commercial Relations
Toronto

Ontario Securities Commission
Toronto

Direction des Entreprises
L'Inspecteur général des Institutions financières
Quebec

Affaires juridiques
Commission des valeurs mobilières du Québec
Montreal

Allenvest Group Limited
Toronto

Jarislowsky, Fraser and Co. Ltd.
Montreal

Bolton Tremblay
Montreal

Le Fonds des professionnels du Québec
Montreal

Affaires nationales
Association du Barreau canadien
Montreal

Ontario Branch
CBA Business Law Section Toronto
Toronto

Quebec Branch
CBA Business Law Section
Montreal

Stikeman, Eliott
Montreal

McMaster Meighen
Ottawa

Companies House
Cardiff, Wales

Department of Trade and Industry
London, England

2.1.5 Case Studies

Four case studies were undertaken to examine how the Directorate was handling the cases of non-compliance with which it became involved. The case studies were chosen to illustrate different problems from a short list of cases provided by the Directorate. Because the evaluation team was not given free range to choose cases, it is not clear how typical the selected cases were.

2.1.6 Focus Group

A focus group of program staff was held to gather their reactions to the consultant's initial findings and recommendations based on all the preceding methodologies. The original intention had been to include outside experts in the group but the consultant was unable to induce them to participate. Participating were the Director General of the Corporations Directorate, the Director of the Compliance Branch, the Director of the Corporate Services Branch, a previous Chief of the Compliance Division, the consultants, the evaluation officer and the Chief of Program Evaluation.

3.0 THE PROGRAM AND ITS APPROACHES TO COMPLIANCE

3.1 Program Profile

While the Corporations Directorate administers a number of acts, the evaluation is limited to the administration of the Canada Business Corporations Act (1975) (CBCA).

The official objectives of the Corporations Program with regard to the CBCA are:

a) to maintain fairness and order in the corporate environment; and
b) to regulate the creation and existence of federal business corporations.

Other objectives, as expressed by program staff, are:

a) to encourage uniformity of corporate law across the country; and
b) to ensure that relevant information for decision making is available to shareholders, creditors, potential shareholders and other interested parties.

Organizationally, the Directorate proper is broadly divided into two groups: the Compliance Branch, which, in addition to enforcement, exemptions and investigations, also handles matters concerning the development and implementation of compliance policy; and the Corporate Services Branch, which handles daily operations and services. There is a fair degree of interaction between the branches as they cooperate on shared functions, for example, the approval of corporate names and compliance programs.

The key "work elements" of the Corporations program in so far as the CBCA is concerned have been grouped as follows:

- Granting Corporate Names and Ruling on Name Disputes
- Incorporating and Changing the Status of Business Corporations
- Processing Applications for Arrangements, Correction of Documents, etc.
- Ruling on Applications for Exemption[11]
- Developing Policy (Compliance and Administration)

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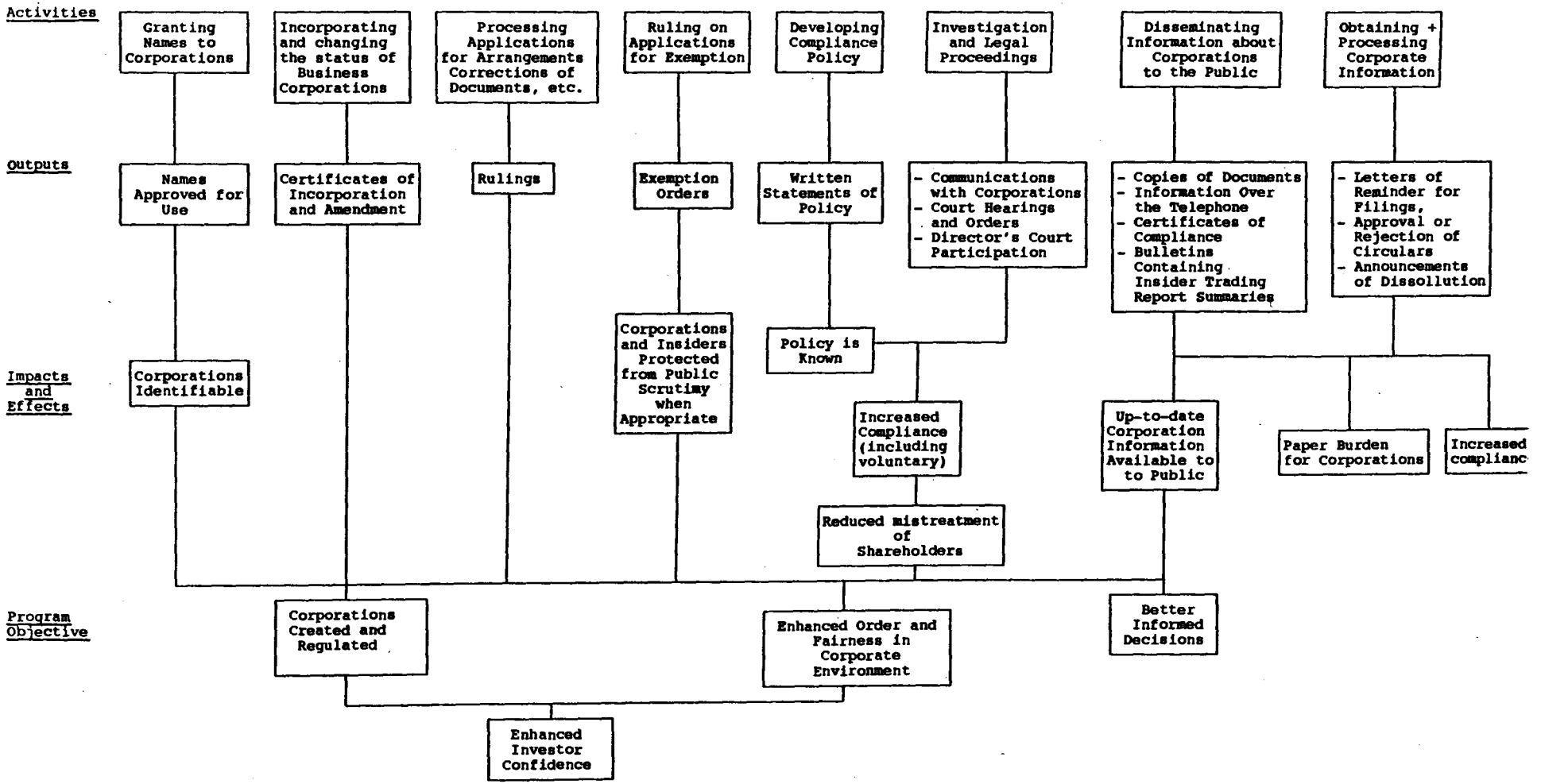
11. Exemptions may be obtained from requirements of the Act for which there is a provision for exemptions.

- Developing Regulations and Guidelines
- Undertaking Investigations and Legal Proceedings
- Disseminating Corporate Information to the Public
- Obtaining and Processing Corporate Information (from Statutory Filings)
- Contributing to Legislative Development

The structure or logic of the Corporations sub-activity is shown in Exhibit I. For each work element, the relevant activities, outputs and effects are shown. The structure presented is that of the ideal program in that the objectives are assumed to be achieved. Outputs are defined to include only those products of the program which the public receives.

EXHIBIT:I
CORPORATIONS SUBACTIVITY
LOGIC CHART



3.2 Observed Compliance Strategy

3.2.1 The Compliance Strategy in Summary

The strategy is built on the basis of **rules** of conduct in the corporate environment contained in the CBCA and the Canada Business Corporation Regulations (the Regulations) and on the offenses and assorted penalties and other **remedies** stipulated in the legislation. The existence of these two ingredients qualifies this as a true compliance system.

The strategy also contains at least two broad and contrasting "orientations": one pro-active and the other reactive.

Proactively, when a need is perceived, efforts are made to convey information to corporations about compliance problem areas. A less discretionary proactive approach is the use of reminders for the annual returns required of corporations under s.263(1). In addition, take-over bid and proxy solicitation documents are actively sought and monitored for compliance.

Reactive approaches include: the mailing of several notices related to enforcement to non-complying corporations under s.212 and for the financial statements required under s.160; the mandated advertising campaign involved in effecting dissolution of a non-complying corporation under s.212; and the investigation of complaints (resulting from third party monitoring) regarding breaches of almost all other sections of the Act. Another form of monitoring could be called "self-certification"[12] (for the annual returns and the financial statements [s.155(1)]).

Methods for dealing with non-compliance include: making an offense of any non-compliance with the Act; civil suits; penalties and occasional prosecution under the Act; dissolution of non-complying corporations; investigations; etc.

The rules of conduct in the corporate environment, information activities, monitoring and enforcement actions constitute the strategy and are elaborated below.

3.2.2 The CBCA Compliance Strategy in Detail

3.2.2.1 Purpose of the CBCA

A Directorate official responsible for compliance expressed the objectives of the Act as follows:

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12. By signature of officer or director.

"The Act sets out standards for corporate behaviour [to ensure] that, if everybody does what they are supposed to do, shareholders and creditors will be treated fairly and the wheels of commerce will not be clogged with excessive bureaucracy."

Corporations Directorate strategic objectives are also relevant to the compliance strategy.

The objectives are...
"to regulate the creation and existence of federal corporations; to maintain order and fairness in the corporate environment."

3.2.2.2 Orientation of the Compliance Strategy

The orientation and purposes of the compliance strategy help to determine methods and priorities of the strategy.

The orientation has a number of elements, as follows:

1. "Self-enforcement"[13] works if the persons required to comply with the Act know what the rules are, are complying with the rules, and, in complying, are self-enforcing the Act.

2. "Private-enforcement" assumes that the Act spells out the normal conduct of affairs in a corporation, the relationships among and between the directors, the officers and the shareholders. The corporation and the Director provide information collected under the Act that enables all the actors to check on one another for compliance. If non-government persons discover non-compliance, they have the options of undertaking "private enforcement" by using the tools and remedies provided in the Act or complaining to the Director under the Act.

3. Enforcement by the Directorate takes place as well.

   i) All complaints received about non-compliance will be analyzed to the point of deciding whether there are grounds for intervention by the Director. This applies especially to complaints relating to proxy circulars, take-over bids, fraud, oppression, denial of access to

13. This nomenclature was used in the past to encompass both the ideas of self-enforcement and private-enforcement described here. We have divided the concepts in order to be more precise.

corporate records and securing copies of financial statements. It would also apply to illegal or improper insider-trading, but few such complaints are received by the Directorate.

Action will be undertaken in regard to all justified complaints. In most cases considered to be of a private[14] nature, this will likely take the form of a letter informing the complainant that he himself, can take the matter to court. In other cases, action will take whatever form is needed to effect compliance, beginning with information approaches by telephone and letter and moving on to formal notice, through application for compliance orders (under s.240) to civil suits or prosecutions (which are technically possible for any failure to perform a requirement of the Act).

ii) A pro-active approach/orientation is adopted regarding requirements to file annual returns and financial statements. Prior notice and reminders are sent. Compliance is monitored by computer.

As with justified complaints (4 above), all non-compliance with requirements for annual returns and financial statements is followed up in some way, sometimes ending with dissolution of the corporation, by the Director, under s.212(1).

3.2.2.3 The Rules

The legislation forms part of the rules element of the compliance system and consists of the CBCA and the Regulations.

It requires or authorizes a wide range of conduct and action by corporations, directors, officers, shareholders, creditors and the Director appointed under the CBCA. Though there are many required actions, only very few prompt an administrative or legal response by the Directorate when they fail to be performed and even fewer are the subject of a pro-active approach.

Failure to perform any required action is an offence, except possibly failure by the Director to perform a required action, since the Act does not indicate that either the Crown or the Director is bound by the legislation.

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14. Cases are more likely to be considered private, the fewer the number of shareholders allegedly wronged. Other circumstances can be taken into account so that even a case involving few shareholders may still receive intervention by the Director.

Policies of the Directorate, internal guidelines and other material not made available to the general public do not form part of the rules, since members of the public cannot be expected to conform to hidden requirements. Policies, guidelines, etc. which are disseminated to the public, readily accessible, and intended by the Directorate to illuminate the way in which the Director's discretion will or may be exercised, may properly be regarded as part of the rules.

Disseminated policies or guidelines apparently are not part of the Directorate's usual approach to compliance enhancement. An exception to this generalization is the "Notice to Clients" on the use of the "Uniform Insider Trading Report" form. The Notice, which appeared in the Directorate's "Bulletin", proclaimed the acceptability of this form even though the Regulations require use of a different form.

3.2.2.4 Education and Information for Regulatees

According to Directorate officials, relatively little educational action is taken currently regarding most provisions of the Act. The Director makes four to five speeches a year to outside audiences, drawing their attention to issues that may be creating compliance problems. In addition, there are infrequent notices on Directorate policies and interpretations in the "Canada Corporations Bulletin", which is published by the Directorate every month. Also rare, but sometimes used, are public notes on policies based on information provided by the Directorate to CCH and Richard De Boo publishers. Finally, meetings attended by Directorate officials offer a setting for informal exchanges of information about the Act. There are not many opportunities for this.

A very extensive, largely "automatic" information campaign notifies corporations of their obligation to file annual returns and financial statements. Notices after the due date request compliance, thereby completing the information program designed to enhance compliance. Some 150,000 notices and forms are sent out each year for annual returns and 8,000 to 10,000 for financial statements.

When a corporation fails to file financial statements, the Director may prosecute. When a corporation fails to file its annual return or application fee, the Director may eventually take steps to dissolve the corporation. The legislation requires publication of a notice of the Director's decision to dissolve in a newspaper "published or distributed" in the place where the corporation has its registered office [s.212(s)]. Publication is limited severely by lack of funds.

An additional information activity, also mandated by the Act, (s.129) consists of publication in the Bulletin of summaries of all insider reports received by the Director. These data, together with the other information contained in the Bulletin, may encourage compliance by conveying information on compliance, exemptions and, on occasion, non-compliance by defaulting corporations. The Bulletin used to have a circulation of some 900 copies per issue, but this has fallen recently because of price increases. In 1988, 57% were distributed to libraries, a place where they would be well situated to reach people interested in learning about rules and in monitoring the behaviour of corporations.

3.2.2.5 Consultation on the Rules

Consultation with regulatees and others likely to be affected by regulation about proposed changes to regulations has been required under the Federal Regulatory Review policy, since early 1987.

The CBCA itself [ss.261(2)] requires, with the exceptions outlined in ss.261(3), publication of proposed regulations in the Canada Gazette (and in the "Bulletin") 60 days in advance of the planned date of coming into force of the regulation. This gives interested persons a chance to make representation regarding the proposed new rules.

A consultation was apparently confined to other regulatory agencies. The "Uniform Insider Trading Report" used at the federal and provincial levels, was developed and adopted without the Directorate obtaining comments from regulatees.

3.2.2.6 Compliance Monitoring

Monitoring is conducted in several ways:

1. Review of Annual Filings and Financial Returns

   The Directorate reviews over 12,000 corporation files yearly to provide requesters with "certificates of compliance" under s.263(2). At the time of this study, this process confirmed only that annual return forms, with the necessary fee, had been received. It did not confirm that they contained any information. The completeness or accuracy of financial statements was also not confirmed by the certificates of compliance. The Directorate has since changed its procedures so that forms are now required to be at least partially completed in order to receive certificates of compliance. Accuracy is still not verified because of the cost and difficulty of doing so.

2. Press Review

Canadian business newspapers are read daily by the Directorate for reports on shareholders' meetings, take-overs and other relevant corporate events. Virtually any event mentioned is reviewed by the director of the Compliance Branch. The documents in the Directorate's file on the event, as well as annual filings by the corporations concerned, are reviewed for compliance; action is taken if required.

3. Examination of Proxy Circulars and Take-Over Bid Circulars

The examination of circulars is a major pro-active form of monitoring. In 1988-89, 656 proxy circular documents and 41 take-over bid circulars were examined. In spite of a selection process for review which is designed to focus on problem cases, deficiency rates were very low for proxies: 21 documents - with a total of 26 deficiencies - out of 656, representing 3.2% of the total. Data on deficiencies in take-over bid circulars (100% sample) for 1988-89 show an even lower rate of non-compliance (3%).

Complaints from Third Parties

"Third-party monitoring" is the main source of information on possible compliance problems, apart from those arising out of the requirement for annual returns and financial statements. In 1988-89, 61 complaints led to the opening of 61 investigations. The four largest groupings of investigations concerned take-over bids (12); filings of address or change of address and directors or change of directors (8); expenses incurred by the corporation (6); and proxy material (5).

4. Public Examinations of Directorate Files

Corporation files held in the Directorate may be examined in the Directorate offices by anyone wishing to do so and copies are available for a fee. This process contributes to monitoring, since deficiencies in compliance can be detected in this way.

5. Automated Review of Annual Returns and Financial Statements

In so far as monitoring is concerned, eighty days after the Directorate sends blank annual return forms with a notice of the required fee, an automated review registers whether the required return has been received and, if not, causes a deficiency notice to be sent to the non-complying corporation. If there is still no response after more than one

year, a notice of intent to dissolve is sent both to the corporation and its directors. If continued monitoring still finds no response and the Directorate has the funds, it publishes its intent to dissolve the Corporation in the Canada Gazette and newspapers. If it does not have the funds no action is taken until the funds are available.

3.2.2.7 Responses to Non-Compliance (Enforcement)

Responses to non-compliance are also multi-faceted.

1. Dissolution

   After corporations have been given repeated opportunities to comply and notices have been published in both the Canada Gazette and the appro-priate newspaper, the Director may dissolve corporations that have not filed annual returns.

2. Refusals

   The Director can reject or refuse to file various articles (s.245) and certificates [ss.256(2)][15] if non-compliance is involved. He may also refuse certain other well defined requests made of him.

3. Rectification Action

   Contact with non-compliers can lead to rectification action with regard to deficiencies in compliance that can and should be immediately corrected. For example, there were two such deficiencies in take-over bids in 1988-89 and rectification was immediately achieved. Similarly, regarding proxy circulars, there were twenty-two cases in 1987-88. Twenty were corrected following a reminder letter and two, needing immediate rectification, resulted in rapid compliance.

4. Prosecution

   Prosecution mostly results from failure to comply with financial statements or timely disclosure requirements. Fines are relatively small. In March 1989, fines totalled $1450 for 13 convictions for failure to comply with financial statement disclosure rules. Prosecutions are allowed for other offenses but are usually not initiated except for self-

15. "The Director may furnish ..." underlining added.

evident offenses. This occurs partly because the inquiry provisions of the Act cannot compel people to respond and partly because it is considered more cost-justified to achieve compliance by direct means ie. rectification action.

5. Civil Suit on Behalf of Shareholders or the Corporation

These can take place under the "Oppression Remedy", usually used to protect shareholders or as a "Derivative Action" to protect the corporation. In 1988-89, the Director concluded by way of an out of court settlement one court action under the Oppression Remedy. One other such suit is still in progress. For Derivative Actions, there is one such action under way.

4.0 FINDINGS

4.1 Summary of Findings

For a summary of findings, please refer to the executive summary.

4.2 Detailed Findings

4.2.1 Findings Regarding Compliance

1. Because survey respondents perceive the requirements of the Act to be well complied with and yet did not give high effectiveness ratings to Directorate activities presently used to encourage compliance, one can conclude that most compliance is perceived by surveyed clients to be voluntary, rather than in reaction to efforts by the Directorate. Even assuming this perception is correct, efforts of the Directorate are still relevant to motivate additional compliance.

2. Clients of the program do not perceive that there is wide-spread non-compliance; however, those connected with closely held firms perceive slightly more non-compliance than do others.

3. Non-compliance is perceived to be a problem somewhat more often in the areas of: corporate treatment of shareholders; insider trading; submission of annual returns; shareholder information and meetings; and quality of financial statements. We say "somewhat" because very few respondents named specific areas of non-compliance and those that did were likely to be influenced by the type of client that they were. For example, market professionals were especially concerned about illegal insider trading. The interviews of experts indicated that: a frequent area of shareholder mistreatment or "oppression" involved favouritism in the buying back of shares by the corporation; insider trading provisions were not well understood regarding definitions of required and illegal types of behaviour; the failure to hold meetings often occurred because of time pressures to make decisions; and the need and importance of submitting financial statements or annual returns filing was not well understood. The interviewed experts identified additional areas with problems of non-compliance: the distribution of information to shareholders of private firms; equal treatment of shareholders; and providing access to corporate records.

Comments from survey respondents imply that the form of non-compliance regarding annual returns is that they are not submitted whereas the problem with financial statements is that they are inaccurate or misleading.[16]

4. Lack of knowledge and understanding of CBCA requirements was by far the most popular reason given first for non-compliance. This was true regardless of the area of non-compliance named by the respondent. The reasons given second appeared more specific to the nature of the non-compliance area. We do not mention these here because of the small number of respondents offering a second reason.

   The interviewed experts indicated that closely held firms are particularly poorly informed about requirements, especially in the areas of shareholder rights, providing information to shareholders, proxy provisions and the filing of financial information. They also thought that publicly held firms did not understand the reason for filing requirements and the specific application of insider trading provisions.

4.2.2 Findings Regarding Directorate Activities

1. There is little awareness of what the Directorate does to encourage compliance.

2. The ratings given by respondents on the effectiveness of particular activities, currently carried out by the Directorate to encourage compliance were similar to each other.
   The threat of dissolution, and the rejection of requests not in compliance were rated as effective Directorate activities. Bordering between somewhat effective and neutral were the activities of: prosecuting firms, applying to court, conducting investigations, prosecuting individuals and warning letters. Respondents were only neutral about the effectiveness of monitoring corporate activities. Directorate officials concurred in this opinion regarding non-automated monitoring in detecting non-compliance.

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16. This view held by survey respondents is consistent with findings in a study by the Ontario Securities Commission, "Office of the Chief Accountant Report on the Financial Statement Review Program".

3. Survey respondents who judged prosecutions[17] or investigations to be ineffective were asked, "Why do you think it's ineffective?" The result was the following support for increasing the amount of these activities:

Activity	Percent of Probed Respondents Suggesting Not Enough Is Done
Prosecuting Individuals	45
Prosecuting Firms	47
Conducting Investigations	46

Some directorate officials supported this view in their interviews in that they were not satisfied with their ability to fully pursue complaints. Case studies indicate that cases receiving full treatment were well handled.

4. Problems with Directorate activities other than low frequency of use were also mentioned:

   i) While lawyers interviewed in depth felt that warnings of financial penalties were quite effective in bringing about compliance, 11.4% of survey respondents said that warning letters are ignored. This may especially apply to warnings of dissolution, since admittedly, these warnings are usually not closely followed by action. Directorate evidence is that the type of warnings that receive early follow-up from the Directorate are significantly more effective than those which do not.

   ii) 14% said that providing information is not effective in encouraging compliance because the availability of information provided by the Directorate for this purpose[18] is not made known.

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17. Some of the respondents may not have been distinguishing between suing and prosecuting.

18. The Directorate provides certificates of compliance and data from annual returns and financial statements of individual corporations.

5. Six potential Directorate activities for improving compliance were presented to respondents. Of these, the following four were rated as effective:

   i) Publicizing the names of convicted firms
   ii) Providing corporations with advice about compliance
   iii) Education on CBCA requirements
   iv) Publicizing a compliance policy on Directorate intervention[19]

   All types of clients supported publicizing the names of convicted firms and experts most often cited "preserving a good corporate image" as the motivation for complying with the CBCA. It is possible that support for publicizing the names of convicted firms also indicated support for publicizing the names of firms successfully sued.

   Respondents connected with closely held firms supported compliance advice and education more than other respondents did. Interviews of experts implied that education on CBCA requirements should include their rationale, especially regarding the need to submit financial statements.

   Those connected with publicly traded firms were more interested in having a compliance policy publicized than were other respondents.

   The effectiveness of increasing the size of fines bordered between neutral and effective in the opinion of survey respondents. Respondents least connected with corporations were the most in favour. Experts felt that raising fine levels would have no impact unless the increases were "astronomical". Providing performance standards[20] was rated as neutral. Again, those furthest removed from corporations were most supportive.

6. When asked what else could be done to reduce non-compliance, most survey respondents had nothing to add to the list of potential activities they had just discussed. However, 15% indicated that more education and increased awareness is needed, and 10% indicated that a more punitive approach is needed.

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19. "Intervention" was not defined but since it was mentioned in the context of activities to encourage compliance we can take it to mean a reaction by the Directorate to non-compliance.

20. An example of a standard was not provided to respondents.

4.2.3 Findings Regarding Private Enforcement and Shareholders' Self-Protection

1. Although the great majority of respondents said they would take action upon discovering non-compliance, independent private enforcement does not appear to be working as a high proportion of the respondents mentioned actions that would require follow-up by the Directorate.

2. The provisions of the CBCA allowing shareholders to protect themselves do not appear to be as effective as one might wish. This opinion is supported by the following findings:

   i) A large portion of respondents (34%) indicated that they did not know what to do when faced with unfair corporate decisions, e.g. these respondents did not even say they would go to a lawyer where, presumably, they could find out. Ignorance of recourses was especially acute for those representing closely held firms.

   ii) Respondents said that the likelihood that shareholders will try to take action is very low (only 15% in the opinion of minority shareholders of closely held firms) and attributed this mainly to the cost and effort required. (During their interviews, some program officials recommended that the Directorate undertake more cases on behalf of shareholders who cannot afford to go to court, perhaps as a result of the survey finding.)

   iii) None of the instruments provided for shareholders alone rated better than neutral. These included: bargaining between affected parties; shareholders' meetings and/or proxy votes; and court proceedings brought by shareholders. On the other hand, statutory disclosure requirements (which are also used by the Directorate) were rated effective in helping to protect shareholders. Non-court methods of shareholder self-protection, such as bargaining or voting, were not rated effective largely because minority shareholders lack sufficient bargaining power.

3. Among survey suggestions for improving the effectiveness of private-enforcement, clarifying the law regarding shareholders' redress was rated as effective by all groups including lawyers. We speculate that unclear wording in law, such as "oppressive" or "unfairly", making results unpredictable, may be one reason shareholder court action appears too costly to respondents.

4. An awareness program regarding shareholders' rights and recourses was very well supported by every group except the representatives of publicly-owned corporations. Interviews of experts revealed that a possible reason for the exception is that shareholders of publicly-owned corporations are perceived to be overwhelmed already with the amount of material provided to them.

5. Using administrative tribunals instead of courts received only a neutral rating.

4.2.4 Findings Regarding Information Services

1. Each of the following types of information is used by at least 28% of respondents: financial statements; prospectuses; proxy circulars, insider trading reports and takeover bid circulars.

2. Of the types of information available from the Directorate, insider trading reports received relatively low ratings from users for timeliness and completeness.

3. Of those not using the information, 10-20% (depending on the type of information) explained that they did not know the Directorate offered it.

4. Most respondents had no problems with the information. Frequent suggestions for improvements were: increase awareness of information availability; increase access to information; and make the information easier to understand and more complete.

5. For all types of information available from the Directorate, at least 22% of respondents wanted the Directorate to continue providing it. Financial statements comprised the type of information that the respondents were most frequently willing to get from sources other than the Directorate in that 71% were willing to obtain it from corporations.[21] Proxy circulars, prospectuses, share and capital structure were other types of information for which the government was not the preferred source (even though respondents were asked to "keep in mind that some published reports are based on federal information").

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21. This figure was 77% for our sample of directors representing minority shareholders of closely held firms and 68% for respondents who spent more of their time dealing with closely held firms.

ANNEX 1

BACKGROUND STUDIES

1. Canada Business Corporations Act:

   Volume I: Detailed Findings From The Survey Of Clients,
   The Coopers and Lybrand Consulting Group

2. Canada Business Corporations Act;

   Volume II: Technical Appendices,
   The Coopers and Lybrand Consulting Group

3. Evaluation and Assessment of the Compliance and Self-Enforcement Strategies for the Canada Business Corporations Act: Interim Report, James F. Hickling Management Consultants Ltd.

4. Evaluation and Assessment of the Compliance and Self-Enforcement Strategies for the Canada Business Corporations Act: Final Report, James F. Hickling Management Consultants Ltd.

5. Report on the Director's Powers Regarding Enforcement of the Canada Business Corporations Act, Michael Hewitt, Program Evaluation Division, Consumer and Corporate Affairs Canada

EVALUATION REPORT: COMPLIANCE STRATEGIES

FOR THE

CANADA BUSINESS CORPORATIONS ACT

RECOMMENDATIONS

Program Evaluation Division
Strategic Planning and Corporate
Services Branch
July 14, 1992

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EVALUATION RECOMMENDATIONS

1.0 SUMMARY OF RECOMMENDATIONS IN ORDER OF PRIORITY

This section briefly indicates the recommendations in order of priority. There are three priority groupings. The first includes recommendations that are most strongly supported by the evaluation studies and/or which would have the greatest and broadest impact. The second group contains those which are aimed at narrower areas. The last priority recommendation is less pressing in timing. After this summary, the recommendations will be discussed in detail. Further study preparing for implementation of the recommendations will often be required despite the detail presented in this report. The recommendations can involve the Corporations Directorate, the Legislative Review Directorate and Communications Branch.

The recommendations include changes to the Act where these can improve compliance. The ADM of Corporations and Legislative Policy has the power to allocate responsibility for the implementation of the recommendations within his bureau. Therefore, this evaluation report will not concern itself with the roles of the relevant Directorates in implementing recommendations for changes to the Act.

1.1 First Priority Recommendations(in order of introduction)

Two main messages come from the research described in the findings section of this evaluation. The first is that private enforcement is not working well. The second is that most non-compliance results from a lack of knowledge or understanding of requirements. Our top priority recommendations address these findings.

Private enforcement is the main area that needs work. Effective private enforcement requires clear and accessible private enforcement mechanisms and knowlegeable clients. Our recommendations address these needs by:

- facilitating access to and understanding of jurisprudence clarifying shareholders' redress;
- providing for increasing the body of such jurisprudence;
- lowering the cost of private enforcement;
- facilitating access to the courts;
- communicating the above news as well as compliance requirements; and
- providing resources for the above.

The highest priority recommendations in order of introduction[1] are:

1. ENSURE CONSISTENCY IN THE COMPLIANCE ACTIVITIES OF THE DIRECTORATE BY COMPLETING THE DEVELOPMENT OF GUIDELINES FOR COURT INTERVENTION BY THE CORPORATIONS DIRECTORATE.

2. MORE EMPOWERMENT FOR EFFECTIVE PRIVATE ENFORCEMENT.

3. MORE RESOURCES TO IMPLEMENT RECOMMENDATIONS FROM:

   - INSTITUTING COST RECOVERY FOR INFORMATION DISTRIBUTED BY TELEPHONE ON INDIVIDUAL CORPORATIONS

   - STUDYING THE PRIVATIZATION[2] OF THE DISTRIBUTION OF INFORMATION ON INDIVIDUAL CORPORATIONS AS ONE OF SEVERAL ALTERNATIVES FOR INCREASING RESOURCES FOR COMPLIANCE ACTIVITIES. DETERMINE PRACTICAL WAYS OF INDUCING INFORMATION USERS TO INCREASE THEIR SUBSTITUTION OF PRIVATE SOURCES FOR GOVERNMENT SOURCES. THEN, IF THESE WAYS ARE TO BE IMPLEMENTED, NEGOTIATE WITH THE DM TO KEEP RESOURCES SAVED FOR COMPLIANCE ACTIVITIES, FOR EXAMPLE, FACILITATING PRIVATE ENFORCEMENT.

4a. COMMUNICATE COMPLIANCE REQUIREMENTS PRIMARILY TO THOSE WHO NEED TO COMPLY[3] AND SECONDARILY TO SHAREHOLDERS AND OTHER RELEVANT CLIENTS OF THE PROGRAM.

4b. COMMUNICATE SHAREHOLDERS' RIGHTS AND RECOURSES TO SHAREHOLDERS AND TO THOSE WHO NEED TO COMPLY

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1. The reasons for this order of introduction are given in section 2.1.

2. The government's recent agreement with PSAC does not appear to impact on this recommendation.

3. Usually connected with managing corporations.

5. THROUGHOUT THE IMPLEMENTATION OF 1-4 AND BEYOND, IN ALLOCATING COMPLIANCE RESOURCES AMONG NON-COMPLIANCE AREAS[4], GIVE PRIORITY TO THE PROBLEM NON-COMPLIANCE AREAS MOST FREQUENTLY IDENTIFIED IN THE SURVEY AND INTERVIEWS OF EXPERTS

1. INSIDER TRADING;
2. CORPORATE TREATMENT OF SHAREHOLDERS;
3. SUBMISSION OF ANNUAL RETURNS;
4. SHAREHOLDER INFORMATION AND MEETINGS;
5. QUALITY OF FINANCIAL STATEMENTS.

1.2 Second Priority Recommendations

The second priority recommendations are aimed at improving service to clients by increasing compliance and facilitating fairness to clients. Enhancing compliance helps clients because the legislation and regulations were written to provide for and encourage fairness in the interactions between them.

Legislative and regulatory review should always involve consultation with clients. The above categories of recommendations include reviews or action in the areas of: clarifying definitions of required and illegal types of insider behaviour; the implications, for injured parties trying to collect damages, of increasing the level of fines; and simplifying language in regulations.

1.3 Third Priority Recommendations

The third priority recommendation enhances relations with clients by taking some of their individual circumstances into account.

4. Unless other areas are identified in later research.

2.0 DISCUSSION OF EVALUATION RECOMMENDATIONS

2.1 First Priority Recommendations (In Order of Implementation)

These recommendations work together in an integrated way to facilitate private enforcement and increase compliance. The order of introduction of the first priority recommendations was chosen to:

- provide the ground rules for Directorate court activity so that jurisprudence would be available for use in private enforcement;
- delay communications efforts until private enforcement tools could be in place. In this way, communications efforts would not result in unmeetable demands for intervention from the Directorate;
- provide resources to help to pay for the communication and other compliance efforts.

The facilitation of private enforcement bears special mention because of the interest of the Department in decreasing its burden of enforcement by relying more on the private sector. This philosophy helped to shape the revision of the CBCA in 1975. Our finding that private enforcement is not perceived to be working well points to the need for careful thought in the design of programs depending on private enforcement. In this particular case, the design should be improved by clarifying the application of redress or private enforcement mechanisms, making the avenues of redress more accessible and communicating these improvements to clients of the program.

1. ENSURE CONSISTENCY IN THE COMPLIANCE ACTIVITIES OF THE DIRECTORATE BY COMPLETING THE DEVELOPMENT OF GUIDELINES[5] FOR COURT INTERVENTION BY THE CORPORATIONS DIRECTORATE.

How to Implement

a. Make clear the factors taken into account in their development.
b. Up date as new factors come to light.
c. Consider communicating the guidelines after they have been completed. If they are publicized it should be made clear that such intervention will normally take place only in cases where public interest is to be protected, or vital corporate law principles need to be upheld[6] and that guidelines are subject to change if new facts or factors influencing the guidelines come to light.

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5. We are pleased to note that the Directorate was developing guidelines for these activities about the time that we were writing the first draft of this report.

6. We have used the words "public...upheld" at the request of Corporations Directorate.

Evidence of Need

The Directorate has not completed the guidelines for court intervention nor indicated the factors taken into account in their derivation to date. During the interview phase of the evaluation, the Directorate was not clear about the criteria it used in deciding to intervene. Guidelines will provide the benefits described below.

Costs

Costs will depend upon the level of detail developed. A total of one person year is possible.

Benefits

The exercise will help the Directorate develop a more clear sense of purpose. Intervention decisions will be easier to make and more obviously consistent and fair. The perception of fairness is an important incentive for compliance. Having the guidelines in place will ensure appropriate attempts to generate jurisprudence that would clarify shareholders' redress(see next recommendation). Over time, even if the guidelines are not published, clients of the program or their advisors will develop a better sense of when private enforcement is in order by observing when the Director under the Act does or does not intervene and the consistency in these decisions.

2. *MORE EMPOWERMENT FOR EFFECTIVE PRIVATE ENFORCEMENT.*

How to Implement

a. Distribute references to summaries of existing jurisprudence and develop and distribute up-dates to the summaries and a Director's policy to clarify shareholders' redress for oppression or other malfeasance;

As appropriate cases arise which would otherwise not go forward effectively, if the Directorate has the resources, it should develop jurisprudence to clarify shareholders' redress.

If the above recommendations do not appear to work, develop changes to the Act to clarify shareholders' redress[7].

7. Concern has been expressed that making the Act too specific may limit its application. Nevertheless, lawyers responding to the survey and in the interviews of experts, strongly endorsed the idea of clarifying shareholders' redress in the Act. As a compromise between the two views, revision of the Act is recommended only as a last resort.

b. Undertake research to find ways, perhaps by changing the Act, to lower the cost of private enforcement or the private obtaining of redress,

eg. - orders regarding legal fees for oppression,
- provision in the Act that an applicant not be required to give security for costs, including the costs of investigations,
- alternative(non-court) dispute resolution mechanisms.

c. Encourage changes in judicial institutions to facilitate private enforcement, eg., contingent legal fees or class action suits.

d. Communicate a-c to clients of the program.

Evidence of Need

Our studies indicate that private enforcement is not working well:

- oppression of shareholders and others was named as the first problem area of non-compliance.[8]
- respondents[9] said they would cope with non-compliance mainly by involving the Corporations Directorate while the latter feels it does not have the resources to be so involved.
- 34% of respondents indicated that they did not know what to do when faced with unfair corporate decisions.
- respondents perceived that shareholders are not likely to act to obtain correction to unfair treatment because of high costs.
- no instruments provided for shareholders to encourage compliance on their own[10] were rated effective.

Expected Costs

A total non-recurring cost of one person year to:

- clarify shareholders' redress;
- find ways to lower private costs; and
- communicate the above.

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8. Oppression was cited as a problem mainly by respondents who were lawyers, Quebecers and/or associated with closely held firms.

9. See section 2.1.2 for composition of respondents.

10. The instruments rated were: bargaining between affected parties; shareholders' meetings and/or proxy votes; and court proceedings brought by shareholders.

Costs are unknown for additional court cases to clarify shareholders' redress if this is the method chosen. Costs are not included for clarification of the Act as this may not be necessary.

Expected Benefits

- shareholders will be empowered for more and more effective private enforcement;.
- eventually less drain on the resources of the Corporations Directorate to carry out complaint investigation(61 complaints in 1989);
- more credibility for the Act.

3. *MORE RESOURCES TO IMPLEMENT RECOMMENDATIONS FROM:*

- *INSTITUTING COST RECOVERY FOR INFORMATION DISTRIBUTED BY TELEPHONE[11] ON INDIVIDUAL CORPORATIONS*

Evidence of Need

- telephone lines are overcrowded making access to information difficult
- resources are needed for the other recommendations.

11. We understand that cost recovery is already in place for information distributed by mail or fax. The information provided is derived from annual returns and financial statements submitted to the Directorate by individual corporations as required by legislation and regulations.

Evidence of Feasibility

- Alberta has successfully introduced cost recovery for similar telephone services.
- the recorded protocol can ensure that clients know that the information may be out of date before they decide to incur charges[12]

Expected Costs

- a net increment to resources available to the Corporations Directorate is expected.

Expected Benefits

- implementing this recommendation would demonstrate support of government priorities.
- users of telephone information would be less frustrated in getting through.
- telephone information would be rationed to those who need it most, in that the cost to users will discourage non-urgent requests. (those who do not need it so quickly can request it by mail or fax.)
- private benefits would not be subsidized by tax payers and corporations through their fees.
- the good will gained at Treasury Board by cost recovery may be convertible into resources for compliance.

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12. A problem raised regarding this recommendation is that charging for out of date information may make the Department liable. Our recommendation is that users be informed that the information may be out of date before they opt to pay for it. Some research may be necessary to determine if this is a solution.

Sequential recorded messages would remind the caller that

1. There is a charge for the information about specific corporations, including information on whether the firm is federally incorporated or not;
2. Further information is available only for federally incorporated firms.
3. The information may be approximately six weeks out-of-date because of the time it takes to process it under the present system. After the system is automated, this should not be a problem.

If the information requested is for a federally incorporated firm, but the Directorate does not have the information, the call could be free.

2. *MORE RESOURCES FOR COMPLIANCE RECOMMENDATIONS FROM:*

- *INCREASING THE PRIVATIZATION OF THE DISTRIBUTION OF INFORMATION ON INDIVIDUAL*[13] *CORPORATIONS AS ONE OF SEVERAL ALTERNATIVES*[14] FOR INCREASING RESOURCES FOR COMPLIANCE ACTIVITIES. DETERMINE PRACTICAL WAYS OF INDUCING INFORMATION USERS TO INCREASE THEIR SUBSTITUTION OF PRIVATE SOURCES FOR GOVERNMENT SOURCES. THEN, IF THESE WAYS ARE TO BE IMPLEMENTED, NEGOTIATE WITH THE DM TO KEEP RESOURCES SAVED[15] FOR COMPLIANCE ACTIVITIES, FOR EXAMPLE, FACILITATING PRIVATE ENFORCEMENT.

Evidence of Need

- the other recommendations will require resources.
- Treasury Board will provide resources to the Department in return for privatization. The new Workforce Adjustment Policy does not appear to jeopardize this recommendation.
- In 1989 the Directorate handled 86,814 enquiries and provided 29,298 copies of documents and 26,104 certified copies and certificates of compliance

Expected Costs

- a net saving is expected if the study shows that privatization should be implemented.

Expected Benefits

- implementing this recommendation demonstrates support of government priorities.
- more resources could be available for work that only government can do or for work that government is best able to do.

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13. The government's recent agreement with PSAC does not appear to impact on this recommendation.

14. The alternatives would be developed by the Directorate.

15. Some requests for information refer to information that is certified by the Director under the CBCA to be as received by the Directorate. An unresolved legal question is how and whether to maintain certification if information distribution is privatized.

4.a COMMUNICATE COMPLIANCE REQUIREMENTS PRIMARILY TO THOSE WHO NEED TO COMPLY[16] AND SECONDARILY TO SHAREHOLDERS AND OTHER RELEVANT CLIENTS OF THE PROGRAM.

How to Implement

On a continuing basis, the Directorate should:

a. Consult with Canadian Bar Association on communication and education regarding compliance requirements(perhaps the CBA could contribute to distributing the materials developed together).

b. Publicize the availability of information about compliance requirements primarily to those who need to comply and secondarily to relevant clients of the program[17](perhaps through a consultative committee similar to the Intellectual Property Advisory Committee).

c. Provide information on compliance requirements to those who need to comply and other clients of the program.[18] The information should include the rationale for compliance and the benefits of compliance and the costs of non-compliance.

d. Increase the Directorate's participation in meetings, seminars, etc. involving those who need to comply or those who work for them.

e. Provide easily useable information pieces(such as articles) to organizations such as the Chamber of Commerce, CICA,and the securities commissions for use in their existing information vehicles.

f. Develop a higher media profile for the Director under the Act.

Evidence of Need

- the perceived cause of non-compliance was lack of knowledge or understanding of requirements.

Expected Costs

- consultations with Canadian Bar Association and the other organizations mentioned,

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16. Usually connected with managing corporations.

17. All communications targets include those who work for the type of persons mentioned.

18. This recommendation would be implemented for shareholders only after they have been better empowered to look after their interests.

- answering inquiries for information on requirements,
- participation in seminars involving those who need to comply or those working for them.

Expected Benefits

- more compliance due to knowledge of requirements of CBCA.
- more awareness of clients' needs
- eventually less drain on the resources of the Directorate.
- an opportunity for partnership with the Canadian Bar Association

4.b COMMUNICATE SHAREHOLDERS' RIGHTS AND RECOURSES TO SHAREHOLDERS[19] AND TO THOSE WHO NEED TO COMPLY

How to Implement

On a continuing basis, the Directorate should:

a. Consult with Canadian Bar Association on communications and education(perhaps the CBA could contribute to distributing the materials developed together).

b. Together with Communications Branch, develop articles for business specialty publications and community newspapers and weeklies.

c. Together with Communications Branch, develop other vehicles to reach interested shareholders, especially of non-distributing corporations in Quebec. Using plain language, the vehicle should describe shareholders' rights and recourses, making clear that intervention will normally take place only in cases where public interest is to be protected, or vital corporate law principles need to be upheld. The vehicle should indicate that the advice of legal counsel should be obtained if doubts arise. One vehicle suggested for consideration is the use of a "1-800" number.

d. Using these vehicles, mention the Directorate's inquiries into complaints about corporate conduct toward shareholders.

Evidence of Need

- 34% of respondents indicated that they did not know what to do when faced with unfair corporate decisions.
- shareholder treatment was named first as a problem area of non-compliance.

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19. This recommendation would be implemented vis a vis shareholders only after they have been better empowered to look after their interests.

Expected Costs

- Would include:
- consultations with Canadian Bar Association,
- costs of developing articles and other vehicles
- responding to requests for inquiries into corporate conduct and
- participation in seminars involving shareholders or those working for them.

Expected Benefits

- more compliance due to knowledge that shareholders have recourses.
- empowerment of shareholders to ensure that they are treated properly.
- more awareness of shareholders' needs
- an opportunity for partnership with the Canadian Bar Association

5. *THROUGHOUT THE IMPLEMENTATION OF 1-3 AND BEYOND, IN ALLOCATING COMPLIANCE RESOURCES AMONG NON-COMPLIANCE AREAS, GIVE PRIORITY TO THE PROBLEM NON-COMPLIANCE AREAS MOST FREQUENTLY IDENTIFIED IN THE SURVEY AND INTERVIEWS OF EXPERTS*[20]

1. INSIDER TRADING;
2. CORPORATE TREATMENT OF SHAREHOLDERS;
3. SUBMISSION OF ANNUAL RETURNS;
4. SHAREHOLDER INFORMATION AND MEETINGS;
5. QUALITY OF FINANCIAL STATEMENTS.

Evidence of Need

- survey respondents named these problem non-compliance areas.

Expected Costs

- this recommendation only reallocates costs. It refers to the focus for activities rather than recommending new activities.

Expected Benefits

- compliance resources will be used where they can solve problems.

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20. Unless other areas are identified in later research.

2.2 Second Priority Recommendations

A major thrust of PS2000 is to improve service to clients. In the broadest sense, program clients will be served if they are treated fairly and if compliance is enhanced.

The topics covered are:

- incentives for compliance
- facilitating compliance
- monitoring compliance
- facilitating monitoring by government and others
- fairness
- facilitating management of operations

2.2.1 Incentives For Compliance

The following recommendations are intended to provide encouragement for compliance by motivating corporations to protect their reputations.

1. CERTIFICATES OF COMPLIANCE

REGARDING ANNUAL RETURNS, NON-COMPLIANT FIRMS SHOULD BE NOTIFIED, IN THEIR NON-COMPLIANCE NOTICE, THAT THEY WILL BE DENIED CERTIFICATES OF COMPLIANCE IF REQUESTED BY THIRD PARTIES.

Evidence of Need

Submission of annual reports was listed as a problem non-compliance area by respondents and by civil servant experts.

Expected Benefits

This will provide an incentive to comply intermediate in force between a simple notice and dissolving the firm but not as disruptive as the latter.

Expected Costs

Because the same notice can be used for both purposes, the cost of notification of this recommendation should be negligible.

2. *PUBLICITY FOR PROSECUTIONS*

IF ENOUGH IMPROVEMENT IS MADE IN THE INVESTIGATIVE POWERS UNDER THE ACT TO ALLOW MORE SIGNIFICANT PROSECUTIONS (AND FINES) THAN AT PRESENT, THE CORPORATIONS DIRECTORATE SHOULD ENSURE THAT THE MEDIA ARE AWARE OF IMPORTANT PROSECUTIONS.[21]

Evidence of Need

Both respondents and experts felt that reputation is an effective incentive for compliance.

Fines of sufficient size would have an impact, but only to the extent that non-compliers expect to be caught. This expectation would depend in turn on the publicity given to the fine.

Benefits

More compliance.

Costs

The costs of arranging the publicity. There is also the concern about overly punishing the guilty. The level of fines would therefore be a factor in future considerations. At present, considering the low level of most fines and the non-existence of punitive damages, the total amount of punishment is not likely to be large.

Comment

The Director usually issues press releases in cases which warrant public attention. These are usually as a result of investigations related to shareholder complaints as opposed to prosecutions for failure to file financial statements.

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21. This idea has been considered before, but was dropped because publicity for low fines would have resulted. Another matter to take into account is the impact of the Charter of Rights. To alleviate the perception of harassment, publicity, if used, would follow all important court actions by the Director, not only successful ones. The findings of the court could be communicated to the media via ordinary press releases even if they favour the defendant (unless the favoured defendant would prefer no publicity).

2.2.2 Facilitating Compliance

This recommendation will facilitate compliance by clarifying compliance requirements.

IN ACCORDANCE WITH THE DEPARTMENT'S DISCUSSION PAPER, THE LEGISLATION SHOULD CLARIFY THE DEFINITIONS OF THE TYPES OF INSIDER BEHAVIOUR WHICH REQUIRE REPORTING OR WHICH ARE ILLEGAL.

Comment

This recommendation is already paralleled in the Department's discussion paper on insider trading. It is provided to show that our research supports the suggested approach. Both respondents and experts identified insider trading as an important non-compliance area . Both said that lack of understanding of requirements was the first reason for non-compliance.

2.2.3 Monitoring Compliance

Financial statements are used by clients to monitor compliance and make informed investment decisions. This recommendation should lead to financial statements of higher quality, thus benefitting clients and, in the longer term, encouraging better compliance.

IN COORDINATION WITH THE ONTARIO SECURITIES COMMISSION(OSC), THE CORPORATIONS DIRECTORATE SHOULD TRACK THE IMPACT OF OSC ACTIVITIES TO ENSURE PROGRESS IN IMPROVING THE QUALITY OF FINANCIAL STATEMENTS. IF THERE IS NOT ENOUGH PROGRESS, THE DIRECTORATE, IN COORDINATION WITH THE OSC, SHOULD ENCOURAGE THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS(CICA) TO INSTITUTE A SYSTEM TO INCREASE THE ADHERENCE OF ITS MEMBERS TO ITS STANDARDS FOR FINANCIAL STATEMENTS.

Evidence of Need

Survey respondents indicated that the quality of financial statements was a problem. In addition, a study by the OSC showed that financial statements were not meeting the standards of the CICA (as required by our Act).

Expected Benefits

The increased quality of financial statements will enhance investor confidence and decisions. Well based investor confidence is one of the goals of the program.

Expected Costs

Costs would depend on the method of tracking chosen. Consultation costs would also be involved.

2.2.4 Facilitating Monitoring by Government and Others

The monitoring of compliance will lead to its increase, thus benefitting clients.

1. INFORMATION

The provision of information aids in the moitoring of compliance. The public needs to know that the information is available before it can use it.

THE CORPORATIONS DIRECTORATE SHOULD PUBLICIZE THE TYPES OF INFORMATION THAT ARE AVAILABLE ON A COST RECOVERY BASIS.

Evidence of Need

When asked why they did not use certain types of information, respondents often said they did not know it was available.

Expected Benefits

More buyers would help defray the fixed costs of collecting information and thereby make it cheaper. A well informed public is better able to monitor compliance and make sound decisions.

Expected Costs

If this publicity were included in existing vehicles to communicate with the public or clients, the cost would be negligible. While supporting the recommendation, the Directorate feels that additional vehicles are necessary.

2.2.5 Fairness

FINES

HIGH FINES CAN DEPLETE DEFENDANT'S FINANCIAL RESOURCES WHICH COULD BE USED FOR VICTIM'S REDRESS IF THERE WERE A PRIVATE CIVIL SUIT. METHODS SHOULD BE FOUND TO TAKE INTO ACCOUNT: THE NEED FOR A CRIMINAL SANCTION, THE NEED TO REIMBURSE THE DIRECTORATE FOR ITS PROSECUTION COSTS AND THE NEED FOR VICTIMS' REDRESS IN CASES WHERE THERE ARE IDENTIFIABLE VICTIMS OF AN OFFENCE.

Comments

This recommendation arises because of the Department's discussion paper, "Insider Trading and the Canada Business Corporations Act" which was circulated to about 1000 program clients in September, 1991. Its recommendations, amended to take into account the comments received, are expected to go to Parliament towards the end of 1993 or in the first half of 1994. The paper recommended high fines for insider trading. It mentioned the method of putting fines into a fund which could be used for victims' redress, but did not go so far as to recommend one. An alternative could be to adapt section 725(1) of the criminal code for inclusion in the CBCA. The section provides that the court may, at the time the sentence is imposed, order the accused to pay aggrieved persons compensation for loss of property due to the offence. Legal Services Branch could be asked to help research the matter.

Expected Benefits

The victims of non-compliance, the people the program aims to protect, would more likely receive compensation for their losses.

Expected Costs

A non-recurring cost of 6 person months for revising the law to take this problem into account. If the solution is to set up a government fund for victims using the proceeds of the fines, considerable administrative costs could arise.

2. *CHANGE IN REGULATIONS*

Take-over bid and proxy circulars are supposed to be designed to help shareholders protect themselves from unfair decisions. They cannot be used this way if they are difficult to understand.

PROVIDE PLAIN BUT ACCURATE LANGUAGE FOR PARTS OF THE REGULATIONS QUOTED IN NON-GOVERNMENTAL DOCUMENTS SUCH AS TAKE-OVER BID CIRCULARS AND PROXY CIRCULARS.

Evidence of Need

Respondents complained that they could not understand these documents. This would hamper their usefulness to the reader. A member of the directorate suggested that part of the problem could be that regulations are often used verbatim in them.

Expected Benefits

Increased ability for private monitoring and decision making.

Expected Costs

A non-recurring cost of 2 person months.

2.2.6 Facilitating the Management of Operations

OBTAINING AN OVERVIEW:
THE DIRECTORATE SHOULD PREPARE BRIEF TABULAR ANNUAL REPORTS CONTAINING INFORMATION WHICH WOULD HELP IT IN ITS MANAGEMENT EFFORTS. SUCH INFORMATION SHOULD ALSO BE AVAILABLE TO FUTURE EVALUATORS.

Evidence of Need

Program evaluation has unsuccessfully requested the following information in order to provide a context for its recommendations:

1. the allocation of resources among compliance related, information collection, processing, storing and distribution activities;
2. the number of distributed and undistributed corporations and the number of annual returns submitted by them;
3. the number of financial statements received and required by type of corporation[22];
4. the number of involuntary dissolutions
5. the number of compliance related complaints related and unrelated to oppression;
6. the types of complaints and how they were handled by type.
7. the cost of handling complaints;
8. the budget for meetings, seminars, etc.;
9. the costs of telephone service for information on corporations.

Expected Costs

- this information should already be available. The only additional cost should be to put it under one cover.

Expected Benefits

- Program managers would have an overview of their operations and therefore be better able to make decisions about compliance efforts. Program evaluators would be better able to come to an understanding of the program.

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22. This item is expected to become obsolete.

2.3 Third Priority Recommendations

This recommendation concerns improving relations with clients.

1. *FORMS SHOULD BE ADJUSTED SO THAT THEY MAKE SENSE FOR FIRMS WITH ONLY ONE SHAREHOLDER.*

Evidence of Need

The Directorate has received angry comments on annual returns because some requirements do not make sense for single shareholder firms. An example of one change could be that questions about shareholders' meetings be marked "N/A for single shareholder firms". We are not recommending separate forms for these firms.

Expected Benefits

The literature review indicates that clients will have more respect for relevant requirements if their special circumstances are taken into account.

Expected Costs

The costs of the amendment process. Since other amendments are envisaged by the Directorate the cost of these incremental changes should be negligible.